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Governing for the long-term: Strategy and Risk

PwC's 2015 Annual Corporate Directors Survey

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

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

Strategy and risk

Directors continue to focus their attention on overseeing company strategy – but many say they are using longer time horizons than they did just a few years ago. To support this longer-term approach, they are frequently taking into account economic, geopolitical, and environmental macro trends, as well as emerging technological macro trends. All signs point to directors looking further down the road when it comes to strategy oversight.

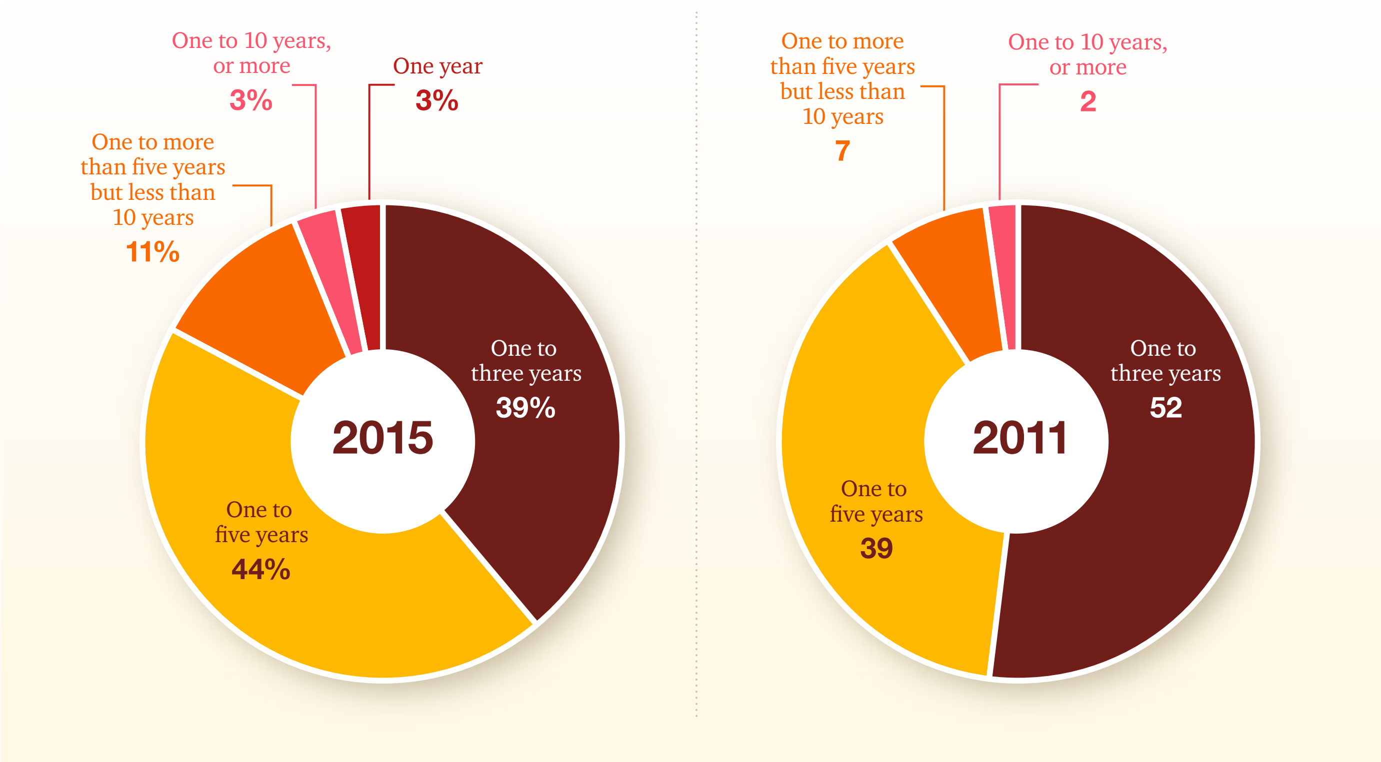
Directors have also become more confident in their ability to oversee risk and are taking more concrete actions to deter fraud and ensure appropriate "tone at the top."

Thinking strategically for the long-term

Boards are responsible for providing strategic oversight in their efforts to enhance long-term shareholder value. A noteworthy development in this area is the use of a longer-term horizon for strategy reviews in recent years; 58% now say their company's strategic time horizon is five years or longer, compared to just 48% who said this in 2011.

In fact, only 42% of directors now say they use a one-to-three-year time horizon in evaluating strategy, compared to 52% who said this four years ago.

When your board is discussing the company's strategy, what time horizon is primarily used?



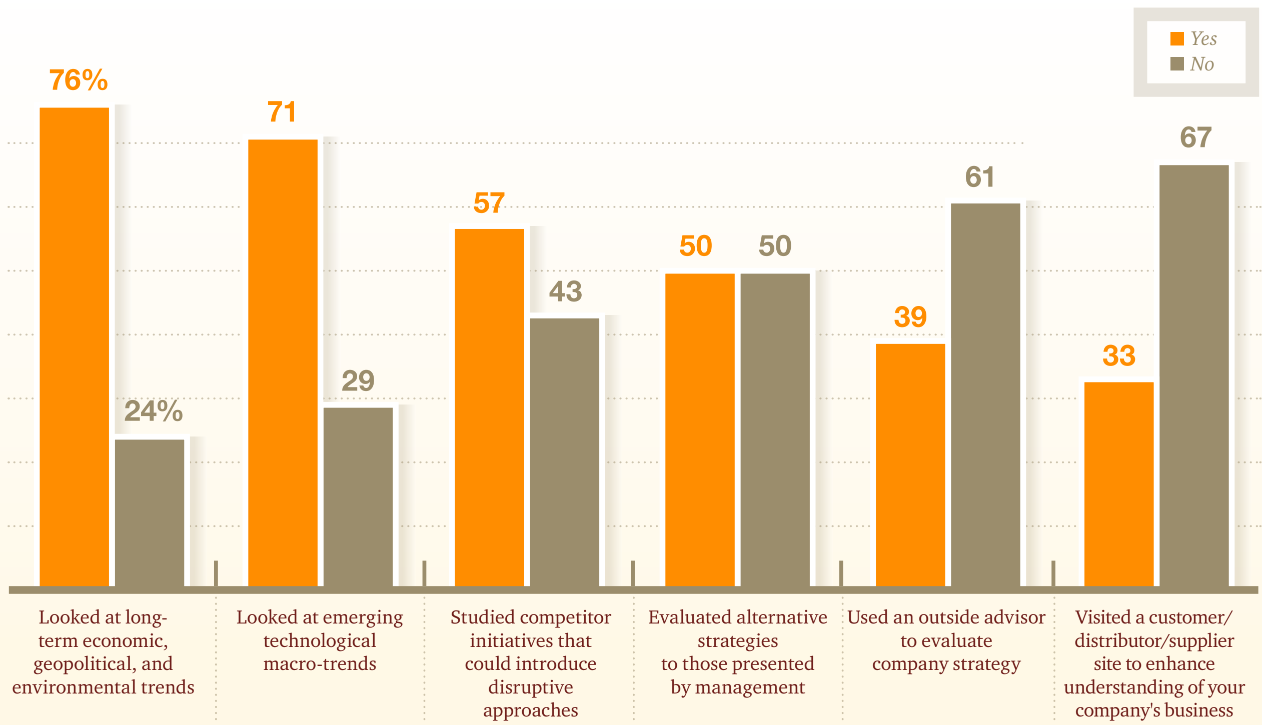
Deeper insights:

- ***Longer-term planning oversight is most prevalent at the largest companies;*** *seven-in-ten mega-cap company directors use a time horizon of at least five years to evaluate their company's strategy, compared to 37% of micro-cap company directors.*

Board approaches to strategy

The effects of macro trends continue to reshape the global economy. So with a longer-term view, directors must consider these trends' impact in order to best position their companies for success. Seventy-six percent of directors say they look at long-term economic, geopolitical, and environmental trends and 71% consider emerging technological macro trends. Additionally, nearly six-in-ten directors study competitor initiatives that could introduce disruptive approaches. However, only half of directors consider alternative strategies to the one presented by management, despite the fact that almost 40% use an outside advisor to evaluate their company's strategy.

Which of the following has your board done in the last 12 months regarding strategy?



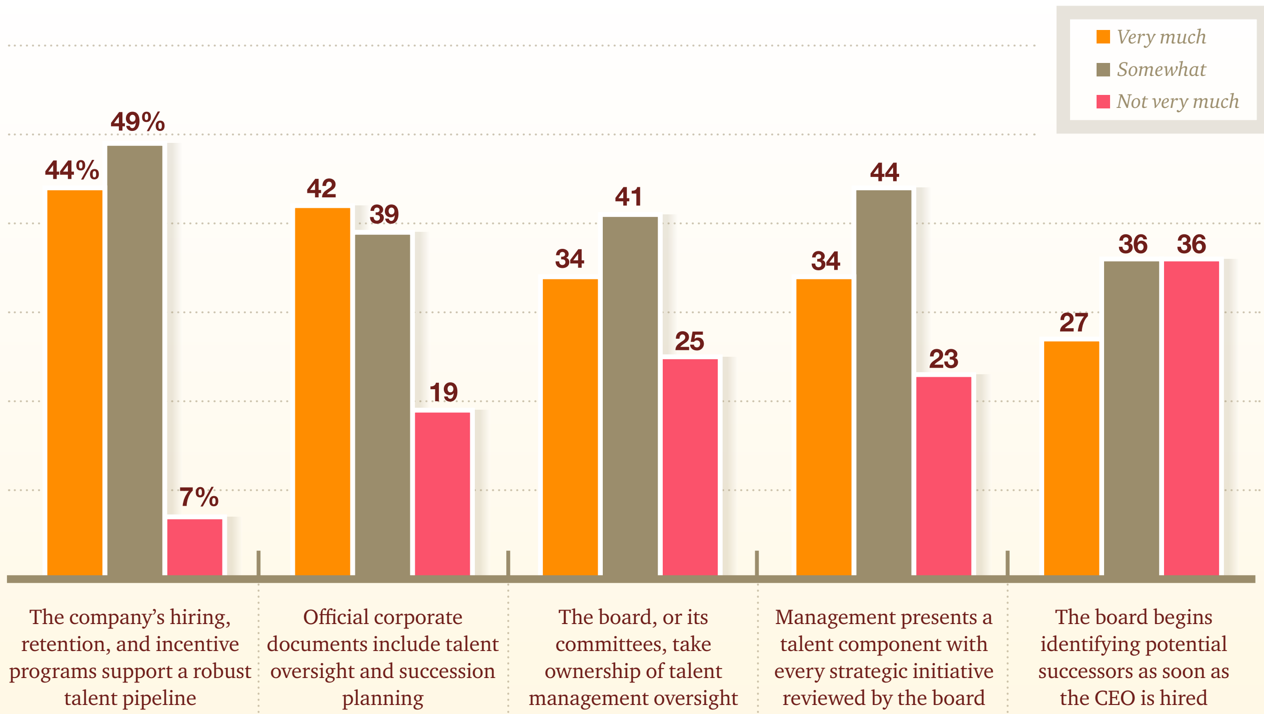
Deeper insights:

- ***The largest companies are more focused on macro trends;*** *directors at mega-cap companies are 21 percentage points more likely to consider economic, geopolitical, and environmental trends in strategy discussions than directors at micro-cap companies.*

Talent management is a key concern

Boards understand that their companies rely on human capital to execute the company's strategy and create long-term shareholder value. As a result, they are involved in talent oversight and express a high degree of confidence in this area; 93% at least "somewhat" agree that their company's hiring, retention, and incentive programs support a robust talent pipeline. Three-quarters or more at least "somewhat" believe company documentation includes talent oversight and succession planning. A similar number agree that their board takes ownership of talent management oversight. However, succession planning remains challenging, as only about a quarter of directors "very much" agree that their board begins identifying potential successors as soon as the CEO is hired.

To what extent do you agree with the following regarding your company's approach to talent management:



Deeper insights:

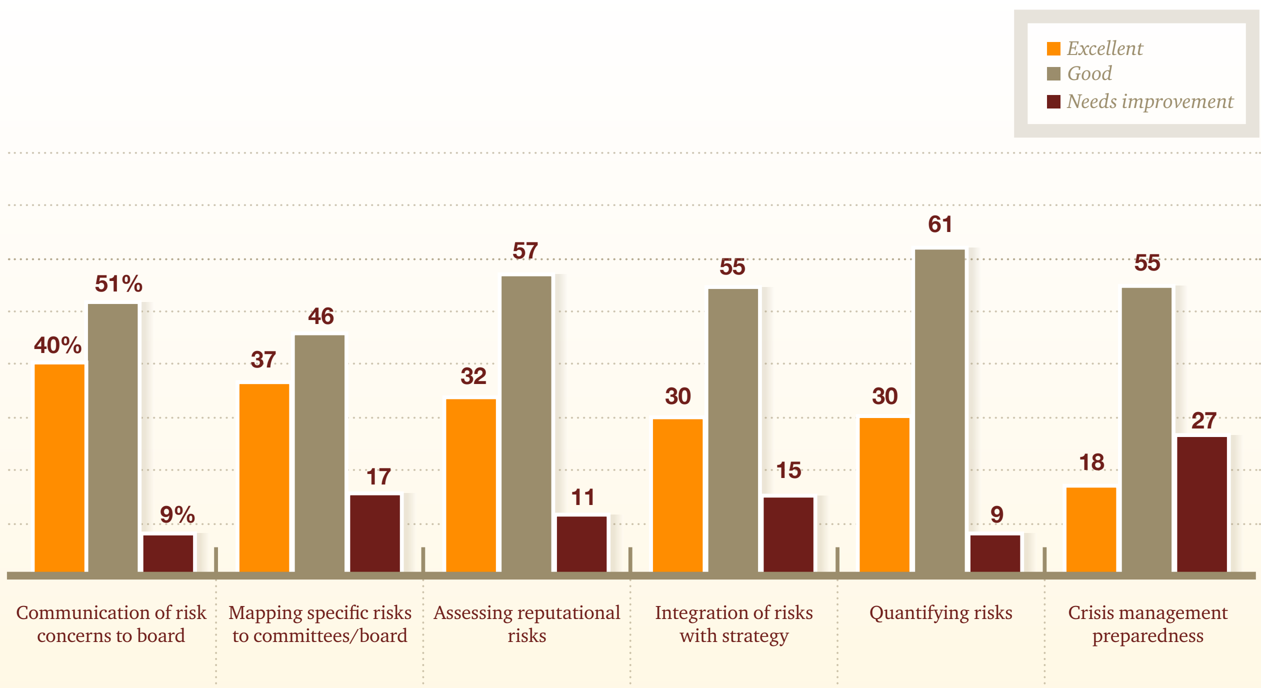
- ***Directors of the smallest companies are more likely to think their boards don't take ownership of talent management oversight;*** *41% of directors at micro-cap companies don't think their board does so, compared to just 16% who don't believe this is the case at mega-cap companies.*

How comfortable are directors with risk oversight?

Ideally, any evaluation of strategy involves integrated board-level discussions of risk. And overall, directors have a high degree of confidence in their board's ability to oversee the risks facing their companies; 91% describe their board's ability to quantify risks as good or excellent. And nine-in-ten say the same of their board's ability to assess reputational risk. Directors are also fairly comfortable with their board's ability to integrate discussions of risk with strategy; 85% of directors describe their board's performance in this area as good or excellent.

The allocation of responsibility for oversight of individual risks is fairly clear; 83% of directors describe their boards as good or excellent at mapping specific risk areas to committees or the board. However, directors are less confident in their crisis management preparedness; 27% describe their board's performance in this area as needing improvement.

How do you assess your board's performance in the following risk oversight areas:



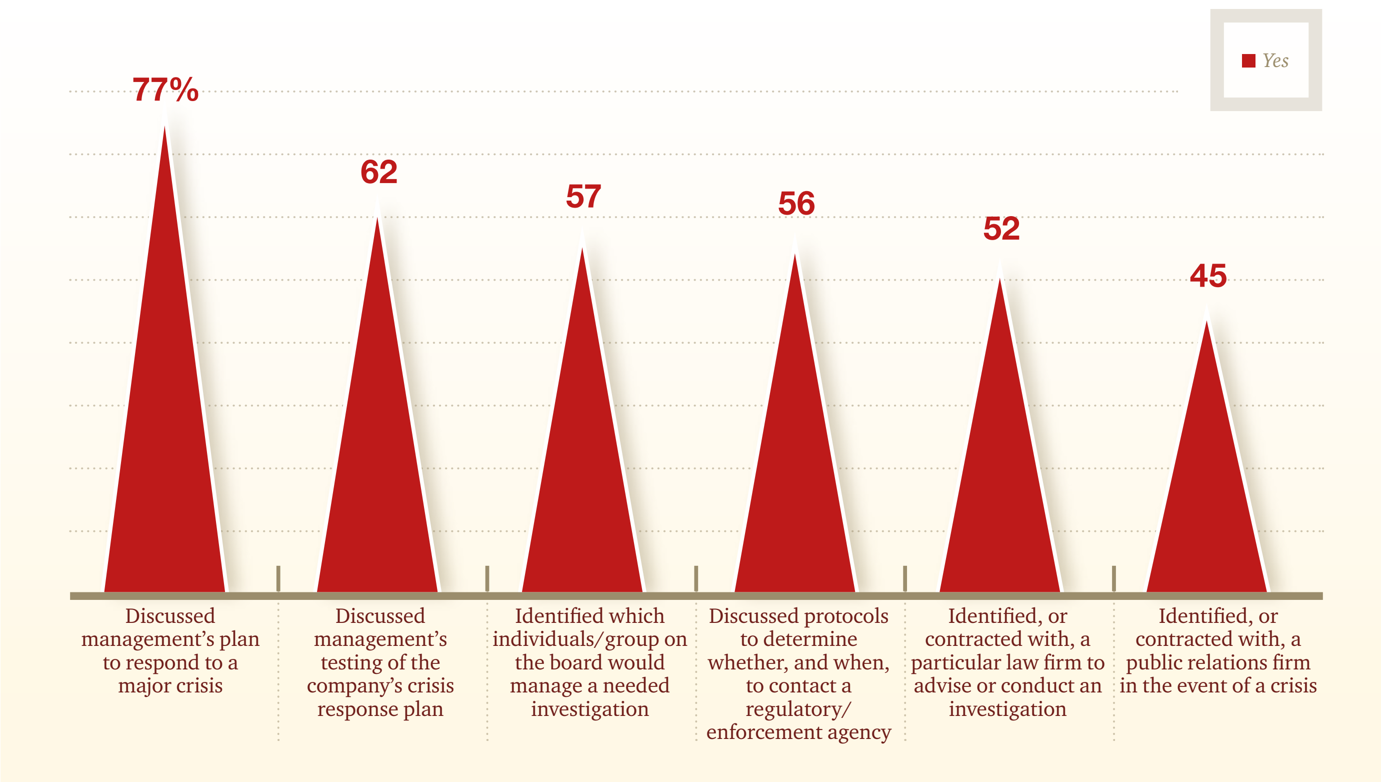
Deeper insights:

- ***The least-tenured directors are less confident in their board's crisis management preparedness;*** *46% of directors with less than one year of tenure think their board oversight of crisis management needs improvement compared to one-in-four directors with more than six years of tenure.*
- ***Directors of the smallest companies are less confident in their board's ability to quantify risks;*** *25% of directors at micro-cap companies say their board's ability to quantify risks needs improvement compared to 5% of directors at mega-cap companies.*

Crisis management oversight practices

Boards should evaluate whether management teams adequately consider the range of events that can impact the company, and have an adequate response plan prepared and tested. Directors are taking substantial ownership of this process; 77% report discussing management's plan to respond to a major crisis and 62% have discussed management's testing of the company's crisis response plan. However, when it comes to the board's preparation for an investigation, only about half of directors say their company has identified or contracted with a particular law firm to advise or conduct a potential investigation, and less than half have identified a public relations firm to assist with communications. In the event of a crisis, time is at a premium and having the proper firms "on the shelf" can increase the company's ability to respond quickly and effectively.

With regard to crisis management oversight (ex. cybersecurity, bribery investigation, financial reporting fraud allegations, etc.), has your board:



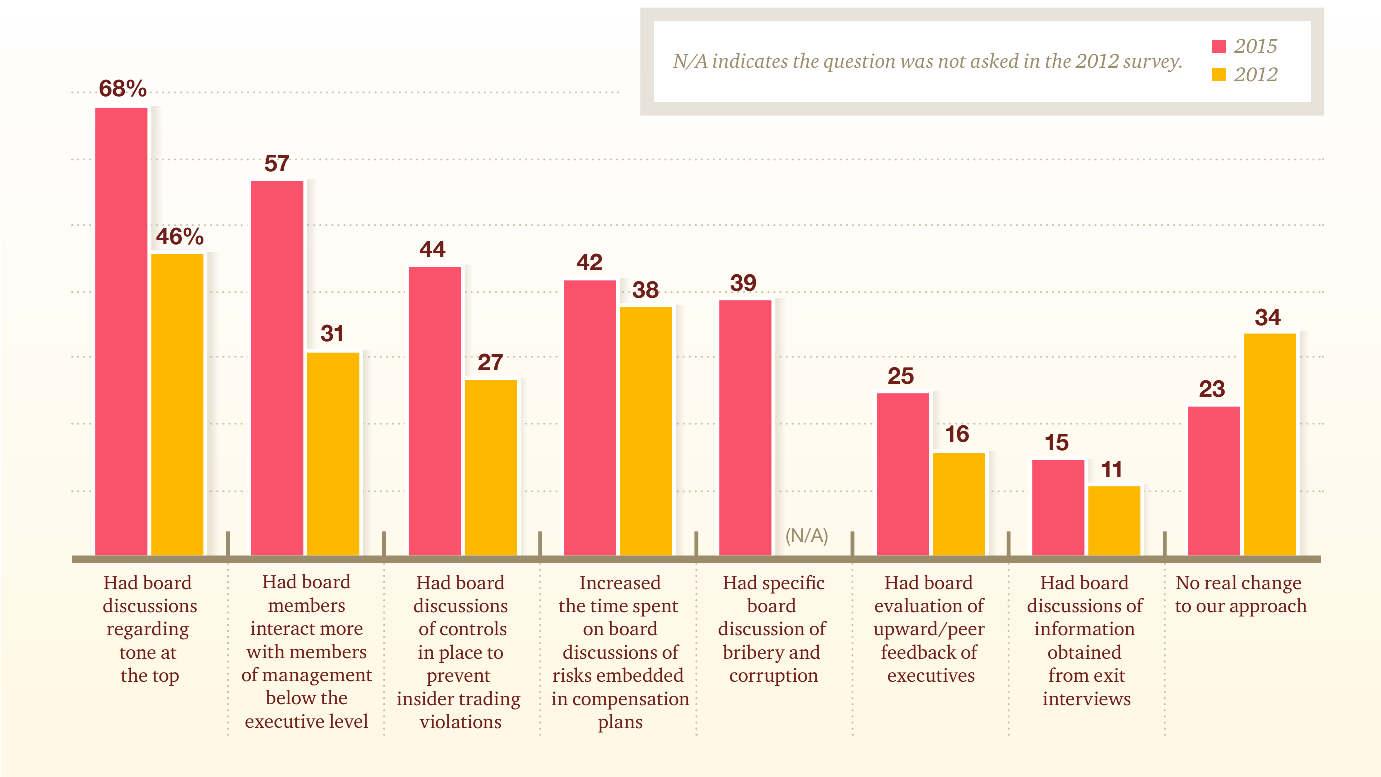
Fraud risk mitigation

Over the last two years, there has been an uptick in reported fraud incidents. On average, 45% of US organizations report they have suffered some type of fraud over that period.[4] And technological advancements have changed the landscape, increasing the number of opportunities to commit fraud, and creating innovative new ways to perpetrate it.

Directors have continued to take action to reduce fraud risk. More than seven-in-ten now say they made changes to their approach to fraud risk over the last 12 months by adopting leading practices. The most common action is holding board discussions of "tone at the top." Sixty-eight percent of directors say their boards had such discussions – a 22 percentage point increase over three years ago. There has also been a significant increase in the percentage of directors who say they have had interactions with members of management below the executive level: 57% did so this year – compared to only 31% in 2012.

Directors are also taking other actions to help deter fraud; 44% increased their discussion of the controls in place to prevent insider trading violations, 39% now report having discussions related to bribery and corruption, and 25% report having board evaluations of upward/peer feedback of executives. Each of these practices are significantly more common now than they were just three years ago.

Which of the following has your board done in the last 12 months to reduce fraud risk?

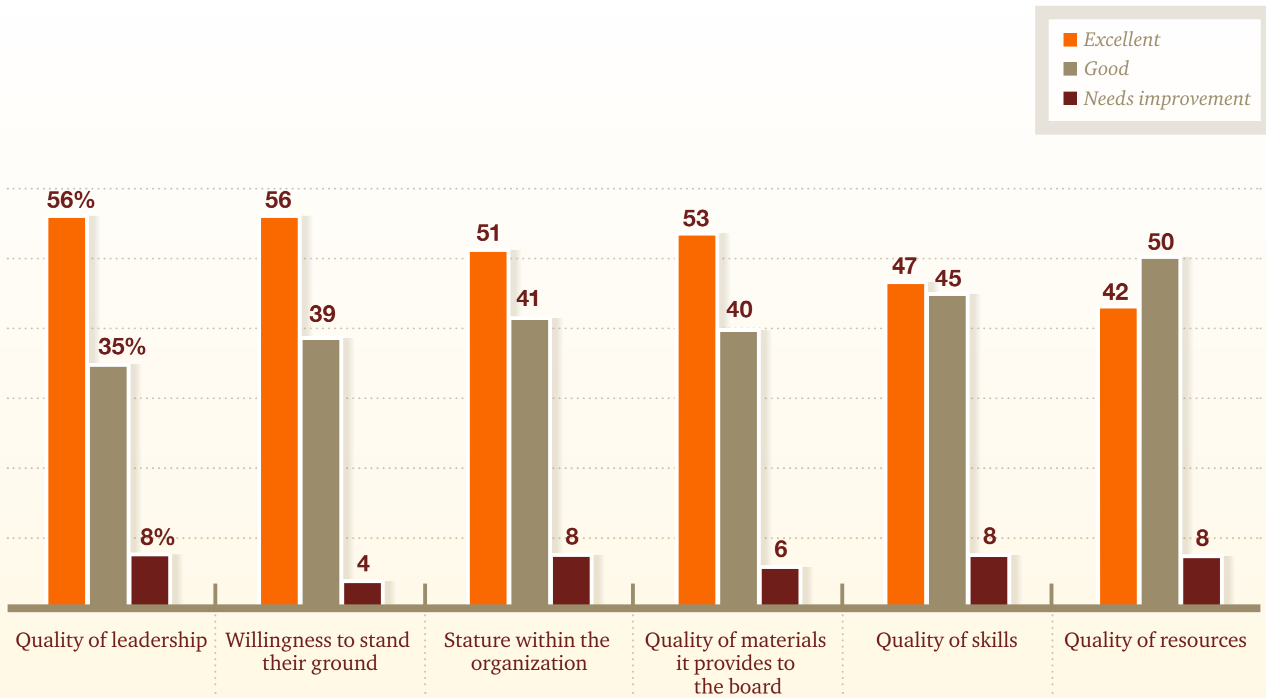


[4] PwC's 2014 *Global Economic Crime Survey*

Perceptions about internal audit

An independent and objective internal audit function can contribute significantly to improving governance, risk management, and internal controls. And because a company's internal audit function plays such a critical role in these areas, the board's view of their capabilities is noteworthy. Audit committee members are generally satisfied in this respect; nine-in-ten describe internal audit's skills, resources, leadership and the materials it provides the committee as either good or excellent. Audit committee members also overwhelmingly believe that the internal audit function is empowered and well respected at their company; 92% describe their stature within the organization as either good or excellent.

How do you assess your company's internal audit function regarding:*



* Indicates audit committee responses only. 1% responded they didn't work with internal audit.

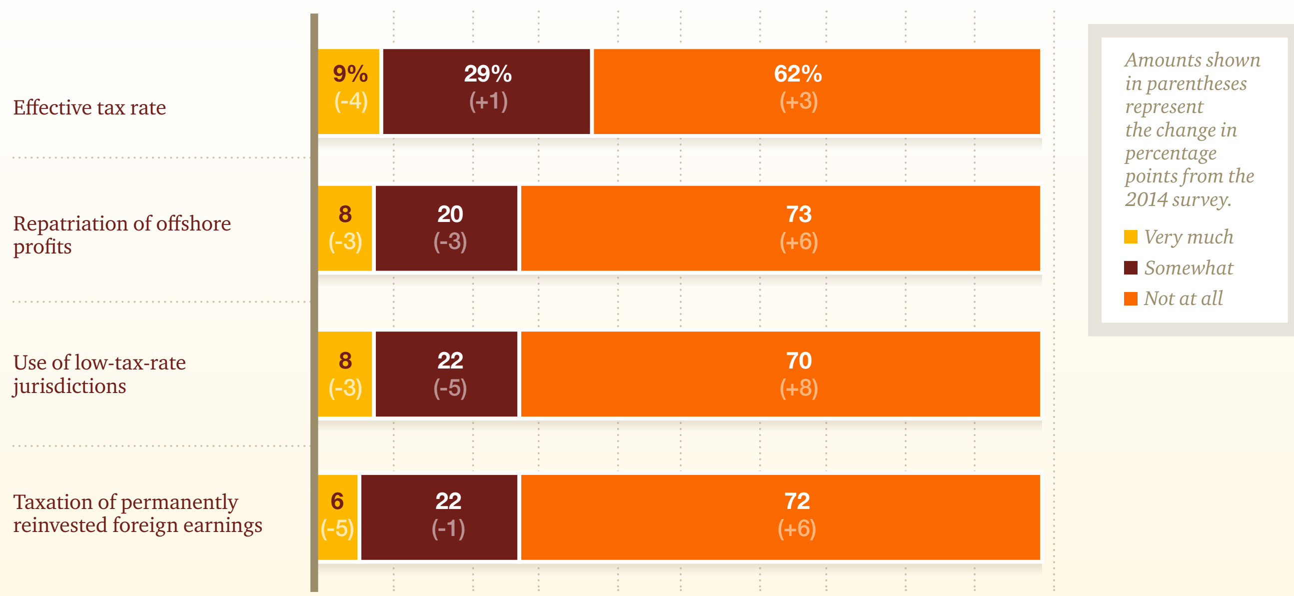
Deeper insights:

- ***Directors of the largest companies have the greatest confidence in the stature of their company's internal audit departments;*** *over 50% of directors at mega-cap companies describe internal audit's stature within the organization as "excellent" compared to 28% of directors of micro-cap companies.*

Are we paying the right amount of taxes?

A few years ago, criticism of corporate tax strategies started to dominate the headlines and public perception of corporate tax issues was on the minds of many. However, over 70% of directors now say their boards did not discuss public perception of a number of tax-related issues this year. These include the taxation of permanently reinvested foreign earnings, repatriation of offshore profits, and the use of low tax-rate jurisdictions. Still, about 38% of directors say they at least "somewhat" discussed public perception of their company's effective corporate tax rate. While not all of these issues are applicable to every public company, directors may still want to consider having board discussions about how their company's broader stakeholders may perceive their tax structure.

To what extent is your board discussing public perception of the company's:



Deeper insights:

- ***Public perception of tax issues is more likely to be discussed at the largest companies;*** *50% of directors at mega-cap companies discussed their company's effective tax rate, compared to only about 35% of directors at small and micro-cap companies.*

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

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