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Issues Shaping the Board Agenda in 2012

Business and Industry Leaders Discuss Issues Poised to Have a High Impact in the Year Ahead

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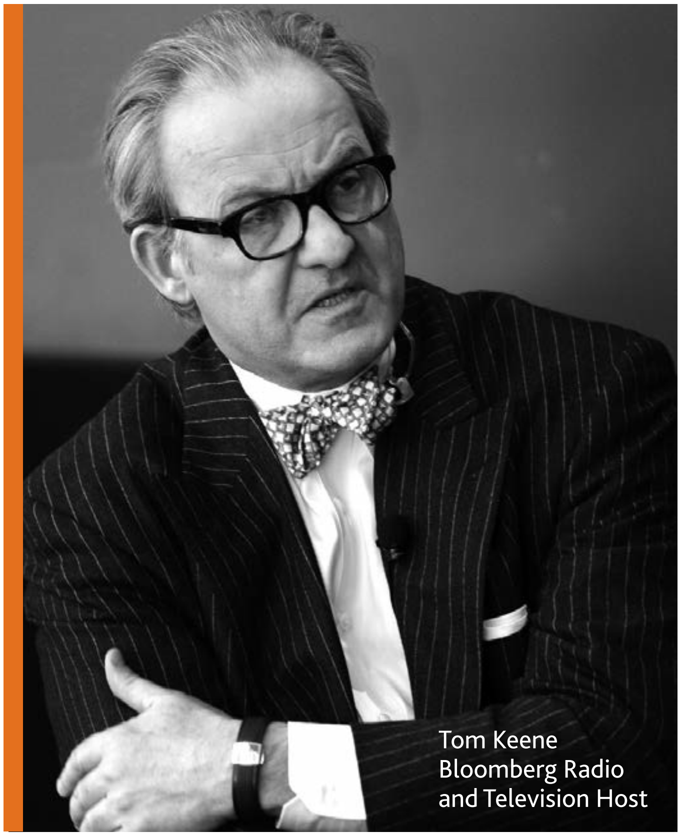
Business and Industry Leaders Discuss Issues Poised to Have a High Impact in the Year Ahead

Shifting economic and market conditions—including the impact of liquidity on growth, increased regulatory scrutiny, and risk oversight responsibility—remain board members' hot button issues. Looking ahead, they will also focus on such issues as their role in strategic planning; expanded transparency of financial reports; the impact of regulation on business growth; and measuring human capital and other intangibles as a component of company strength.

So it was revealed at the J.H. Cohn LLP Board of Directors Series event, "Key Issues Shaping the Board Agenda in 2012," which sought to spark conversation on the issues that matter most to boards, the C-suite, and, in turn, shareholders.

Moderated by Tom Keene (host of "Bloomberg Surveillance" on Bloomberg Radio and anchor of "Surveillance Midday" on Bloomberg Television), the event brought together J.H. Cohn leadership and an intimate group of clients and industry associates, including public company board members, to discuss the issues that matter most to them. What follows is an excerpt of the conversations that took place.



Tom Keene
Bloomberg Radio
and Television Host

PANEL *(from left)*

Tom Keene
Bloomberg

Patrick J. O'Keefe
J.H. Cohn Director of Economic Research

Anthony Zecca
J.H. Cohn, Managing Partner, Cohn Consulting and Governance Practice

Richard Salute
J.H. Cohn Partner, Capital Markets and SEC Practice Director

Dom Esposito
J.H. Cohn Partner, COO, Capital Markets Strategy

On management involvement and information flow in a new business environment

Esposito: Board insight tends to stay at the board level and work its way through senior management, but today we're seeing boards get much deeper into the company's issues and challenges than they did prior to, let's say, 2008. The biggest example is in liquidity. If something goes wrong, will our bank be there, will our insurance company be there, how is the fiscal health of our supplier base? Management is much more involved in these areas than they were before.

Zecca: You're going to see more board portals, which will deliver the information that boards really need to know, the information that drives metrics that matter, the information about what you really need to be concerned about. If you as a board member get that information and can drill down and focus on what's going on, it creates more insight for you. It also creates a better alignment between senior management and the board because both will be looking at the same "report card" that is based on key metrics of performance and risk.

On working lean and the value of human capital

Zecca: A lot of companies went for the low-hanging fruit when things got shaky, but it's more important to work smarter, not necessarily leaner, and redeploy resources to meaningful, value-adding activities. There is a lot more cost rationalization to take place as many companies just reduced headcount without analyzing value-adding activities versus non-value-adding activities. You cannot under-value human capital—it is what makes it all work. If you look at your industry toward the more successful companies compared to the not so successful ones, in many cases the difference is not in some great strategy, but rather in great execution and that is where the value of human capital, from leadership to the shipping dock is actualized.

Salute: You need to know what will make the business successful and what is going to drive your mission. As people get smarter about their organizations, it will naturally keep headcount down. As we speak with clients, particularly those outside the New York Metro area, we learn they are learning to do without the people. They're not, not hiring because they can't, but because they've learned to get the job done without the overhead.

People espouse that they recruit and retain the best and brightest, or that their customer service is a critical success factor, but that's not audited. Stakeholders need to learn the value of an organization's human capital; they deserve to see those metrics to see how management is achieving objectives.

O'Keefe: As boards guide the transition to the new economic reality, they should consider the extent to which long-term success (perhaps survival) will depend on how their organization's human capital (i.e., the core competencies of its entire workforce) stacks up against competitors who view their workforce as a valuable, long-term economic asset in which they (often with government incentives) strategically invest. For most firms the question is no longer, "can we afford the costs of investing in training/educating our workers?", but "can we afford not to?"

This is a question for policymakers in both the public and private sectors.

The ever-increasing importance of human capital presents firms (and the nation) with a stark choice: either we adapt (i.e., change how we educate our workforce, how workers are managed, and how workplaces are regulated) or we atrophy.

On the impact of regulatory focus on the normal course of business

Salute: I don't buy that regulations are killing us, and firmly believe that there needs to be a reasonable umpire to give a fair sense of what's going on and to ensure that we're regulating what we should be regulating. After a certain point, we've gone too far and then certain data regulation makes it difficult for stakeholders to understand what's in place, and why, and what we can learn from it. The financial information we receive today is sometimes issued "old," 30 to 40 days after the event, and that makes it hard to understand what's going on. Data does us no good if nobody can understand it or learn from it. I'm not sufficiently convinced that what is being reported is helpful to management.

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Richard Salute
J.H. Cohn Partner
Capital Markets and
SEC Practice Director

On the "new" risk management process

Zecca: The process has changed and companies are looking at risk management in a new light. We need to focus on the risks happening to key customers and key vendors as well as our own risks. We need to assess all the assumptions our strategies are built on, and peel the onion to look at the risks that might catch us off guard—a financially weakened key customer or a vendor in bankruptcy, for example.

Senior management and the board need to be more involved. Risk needs to move from the back door to the front door; it's no longer a cost issue, it's a survival issue. For lots of companies, risk has been delegated to lower-level management, but the board and senior leaders need to be involved. Also, the risk assessment needs to be more robust than it has been and there needs to be more assurance that the metrics the board and senior management are receiving are aligned with the risks they are trying to manage. Management and boards need to examine risks to their business strategy—what are the risks of those plans not materializing, what are the risks facing our customers and our vendors, what do we need to know to make sure we can manage our own business understanding that something can happen to them. It's not that the process is different, but the world has changed dramatically. We, as business owners and as board members, make lots of assumptions and those assumptions need to be challenged. We need to understand the risks that can catch us off guard.

Patrick J. O'Keefe
J.H. Cohn Director of Economic Research

On the condition of our "animal spirits"

O'Keefe: Our "animal spirits" are alive, but not as well as they once were.

These days, the optimists are too optimistic and the pessimists are too pessimistic. That's because they both think that markets are rational, but what we have is an economy with a multiple personality disorder. Every time new data is published, the optimists declare that things are getting better and the pessimists retort that they are getting worse. They're both convinced that we are in the midst of a conventional recovery from a typical recession.

But the events of 2007 through 2009 involved something more fundamental. The combination of two financial meltdowns (i.e., financial and real estate sectors) and associated contraction in total output were in fact a "retrocession"—a reduction in the economy's long-term growth potential due to the cumulative impacts of several secular trends and the imbalances they produced.

What we are experiencing is not a weak recovery, but an ongoing transition to an economy whose growth potential is somewhat less than in the past. And like that economy, our "animal spirits" are still adjusting to a future of heightened risks and diminished potential.

On board compensation

How should boards be compensated?

Salute: They should be compensated fairly for the responsibilities they take on. Governance is adult supervision, it is adult babysitting, and it is fundamentally impossible to put this responsibility on one group (i.e., the board) and not compensate them fairly for it. You need to pay for quality people. That's what happens in an efficient market. You pay for quality. You won't get quality boards without appropriate levels of compensation. Make them stakeholders and incentivize them to make decisions and recommendations in the best interest of shareholder value.

What is the right size for a board?

Salute: Boards are required to have three independent members to be able to trade, but it's not just size, it's what they bring to the table in terms of experience. Boards need to be strategic. Find people with the experience that you need to move forward. Nobody knows all things. You need help and you need guidance. Smaller boards can be effective if they possess the right skills.

Esposito: A current trend is to put bankers on the board. This didn't exist in the past, but now people want to make sure the bank will deliver when you need them. Someone who has a deep relationship with the banking community can be invaluable in today's turbulent financial services and banking environment.

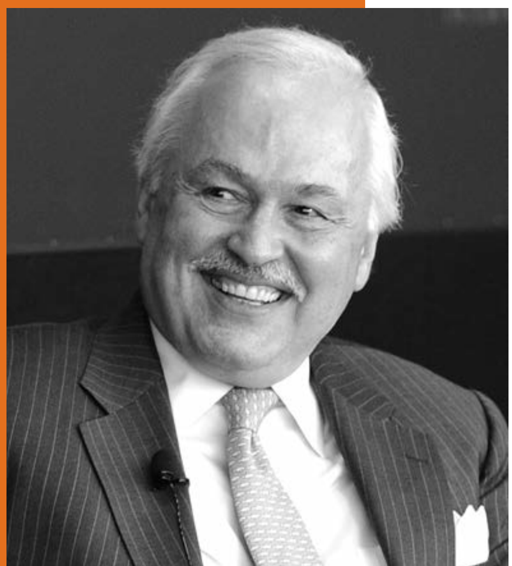
Zecca: You need board members in your industry and outside your industry so that you have a balanced view and a balanced board. Sometimes people from a different industry ask the better questions, the questions that need to be asked to progress, questions that push the envelope and challenge the myths that so many companies operate under.

On governance and its impact on boards

Esposito: The board needs to take deeper dives and be more involved in oversight. I've never seen a situation in which the board goes to employees, but they need to have a more active involvement in strategies and drilling down to areas they probably rarely looked at before.

Zecca: Good governance is good business—period. Governance is making sure you are operating with an effective control environment and with a management structure that creates accountability, transparency, and clear and accurate reporting. Governance is about doing things right and in an environment where tone at the top is based on ethical and responsible competition. New and more powerful whistleblower regulations should force companies to look at areas in which they may have exposure in terms of fraud, bribery, and corruption. A properly governed company should be everyone's goal.

Boards and CEOs should be open-minded. A valuable board will bring diverse perspectives to a management team.



Dom Esposito
J.H. Cohn Partner, COO
Capital Markets Strategy

On board mistakes

Salute: The biggest risk a board can make is being a potted plant and not getting involved. We have to ask not just what are boards doing wrong, but also what do companies do wrong when working with boards. A big mistake management makes is only appointing people who agree with them, people who will let them maintain control. To be successful you need to surround yourself with smart people—they may not always agree with you, but they will always add value and challenge assumptions that you've been remiss in challenging.

Zecca: Board oversight sometimes becomes more routine than it should. Boards need to be more active—not just in managing the business, but understanding it and pushing for a higher level of performance and forcing management out of their comfort zone. Cash is king but growth is like oxygen—can't live without it.

On transparency and continuation of disclosure

Salute: If you're proud of your opinion, you should talk about it. Where I come from, if you don't talk about it, you don't want people to know. You shouldn't be hiding anything. You need disclosures.

On legislation requiring a certain percentage of the board to be female

Esposito: Boards and CEOs should be open-minded. A valuable board will bring diverse perspectives to a management team. Mandating that both sexes be on a board accomplishes that in part, but I really encourage boards to bring the *best* people to task, regardless of gender.

On proposed forced board changes

Salute: The notion of swapping out boards and losing valuable knowledge every five years is preposterous. This isn't anything new. It's something that most European countries mandate, but a formally mandated change in board composition doesn't make sense to me. I do believe that on boards, as with auditors, a team rotation should happen to make sure that the right knowledge is always in place and to keep pace with the current business environment.

On the board's responsibility in succession planning

Salute: It is our job to tell the board if their strategic plan doesn't make sense, if an audit committee is failing, and if their management has begun to fail them. It is, in part, their job to help the company bring aboard management that will help them to stay the course and realize their goals and meet shareholder expectations.

Anthony Zecca
J.H. Cohn Managing Partner,
Cohn Consulting and Governance Practice

Esposito: Grooming the next level of leadership is one of the most critical jobs. You need to set a tone to give younger managers the opportunity to learn and demonstrate their ability to leverage themselves so that when the time comes, they can take on more responsibility. That is one of management's biggest challenges; so many don't have a succession plan in place or it's ineffective so they need to sell the company even though that could be avoided if they had the right team in place for succession.

On the role of boards in executive pay

Zecca: Pay for performance is the way to do it. But performance is much more than just the top or bottom line—it is a more holistic view of performance based on agreed upon metrics and strategic alignment.

On how boards are addressing the financial and regulatory implications of M&A transactions

Esposito: It's pretty dead, but there are still deals being done. They're harder to come by, but we're finding there is less emphasis on what the deal is going to cost versus finding out if there is a good strategic fit. More than ever, it is very difficult to do a bad deal and make it work for you. Boards are focused on the fit and making sure the deal will help them grow. The strategic fit, most importantly, has to do with the attempt to make sure that what an acquirer is looking for, principally in his product line, will be accretive to his bottom line in the near future and be here for the long term.

On using economic data

O'Keefe: Most economic analyses are functionally irrelevant to business decision makers. Not as a matter of substance, but of scope. Simply put: economists produce a flood of information whose practical implications are not readily apparent. It is a lethal flaw from the perspective of a key audience: over-obligated executives and board members.

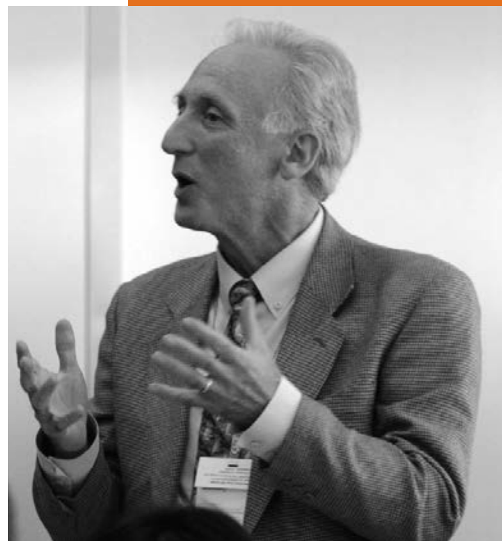
To resolve the too-much-data-not-enough-information dilemma, many decision makers rely on "business economists" (i.e., those who process what others generate) for a few things. First, to translate the torrent of reports into a comprehensible, objective, and succinct summary of current and future economic conditions. Second, to outline the implications of those conditions for their organization. Third, to identify any ancillary issues or options that may warrant consideration. And finally, perhaps most importantly, to refrain from pontificating. The economist's role is to facilitate decision making, not to influence it.

Zecca: Boards need to be trained to ask the right questions about things that haven't even happened yet. Often times, the best questions are the ones that come from left field, but most often we find, when a tragedy occurs and we do a post mortem, that we were never told certain things simply because we didn't ask. Boards need to ask questions, not just accept what management tells them. To do this, boards need a "business intelligence" reporting model (with access to financial data and updated economic indicators) that removes the noise and creates focus on the things that matter.

On board focus

Salute: A board member needs to understand what is driving liquidity. If I was a board member, I would look first at the liquidity statement; everyone says that 'cash is king' but it's frequently overlooked. Boards should see cash statements each quarter to ensure that management is forecasting cash flow. Too often we talk about earnings, but we don't talk about cash positions, and that really gives another layer of insight that an earnings statement will not. At the end of the day, cash is king.

Zecca: Financial statements tell us what happened, not what caused it, and that's what you need to know to really get a complete picture. We need to look at key performance indicators. That's what's most important, because then we can look into the future and see what we need to do to succeed. I think there is a whole new financial statement that is needed, one that encompasses key performance and risk metrics, trends, and anomalies. Management can only take action to change the future, not the past, so financials need to be understood from the perspective of the story the numbers are telling about future results.



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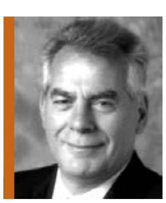

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