

Director Sentiment Trends Toward the Positive

Q3 Board Confidence Index of 56.6 reveals shades of optimism

56.6

Opinion matters. Customarily, well-known opinion polls measure the attitudes of everyone from consumers to chief executives, and just about every four years, party loyalists. What has not been as widely measured is how things are looking in the boardroom. With new regulation being implemented, and shareholder activists lobbying for greater independence between directors and management, *NACD Directorship* felt the time had come to ask the board for its opinion—about governance, economic conditions, profits outlook, employment and hiring and other key performance indicators.

Herewith, the first Board Confidence Index (BCI). This collaboration between *NACD*, Heidrick & Struggles and Pearl Meyer & Partners, is designed to measure boardroom confidence in the economy and in business, reflecting how public

company board directors feel about the overall American business climate, as well as their own companies' prospects now and in the future.

This first *NACD* Board Confidence Index, launched in Q3 2010, realized a middling 56.6, reflecting, we believe, both the natural inclination of boards towards a conservative outlook as well as the effect of the recession on most businesses.

According to the Board Confidence Index, while directors feel the state of the economy has improved over the past year, they are still uncertain about meaningful short-term improvements. The majority, 72 percent, responded affirmatively when asked if they believed general economic conditions have improved compared to a year ago.

When asked if economic conditions have improved compared to the second quarter, however,

43 percent said no, and 31 percent were uncertain.

The data indicates that many directors are cautious, perhaps even skittish, says David Swinford, president and CEO of Pearl Meyer & Partners, the executive compensation-consulting firm. “Frankly, there are two interpretations of this data: how we were a year ago versus how we were last quarter, and what do we see next quarter. It seems the economy recovered some a year ago but has gone flat, as the recovery has slowed significantly. It appears we’re worried that we are headed downhill.”

The results of the first Board Confidence Index also suggests that the recovery is going “to be slow and lumpy. It appears we have taken two steps forward and one step back,” says Heidrick & Struggles Managing Partner Theodore L. Dysart. “In my conversations, and, this is anecdotal rather than research-based, there is great concern about our political environment and where we’re going with broad economic policy.”

Directors’ assessment of conditions in their own industries was slightly less confident than their perceptions of the overall economy. When asked, only 60 percent of respondents indicated conditions had improved in their industry over the past year. Despite the current administration’s claims of the 2010 “Summer of Recovery,” directors’ perceptions of their industry tell a different story. Almost half of respondents indicated conditions had not improved since the last quarter, and 20 percent were uncertain.

Furthermore, nearly two-thirds of respondents were either uncertain or did not believe conditions in their primary industries would improve in the next quarter.

“What I’m drawn to is the uncertainty, and it’s an even distribution across all size companies. This indicates how bumpy this recovery is and how cautious people are being,” notes Dysart; he expects this anxiety will continue through the upcoming mid-term elections in November. “The partisan divide and the possibility of Congress changing over will continue that uncertainty,” he suggested.

The Board Confidence Index also offers a breakdown of respondents by industry size. Smallest

companies (under \$1B), while more confident about the state of their primary industries, are the least optimistic of the overall economic conditions.

Why a BCI?

The Board Confidence Index is an imperative because the influence of today’s public-company boards is an increasingly influential constituency: Directors’ input into corporate risk-management, regulatory oversight and strategic development reverberate throughout the larger economy.

“Board opinion matters because directors provide significant input into business strategy and approve management’s recommendations,” says Swinford. “Building for the future starts with the board. If they are confident in the future, they will invest, and to the extent that they are cautious or skittish will be

BCI Advisory Council

Robert L. Barnett, former executive VP, Motorola; director, Central VT Public Service Corp., EF Johnson Technologies, Johnson Controls, USG Corp.

Dennis Beresford, Ernst & Young Executive Professor of Accounting in the School of Accounting at the University of Georgia’s Terry College of Business; director, Fannie Mae, Kimberly-Clark and Legg Mason

Curtis Crawford, president and CEO, XCEO; director, duPont, E.I., ITT, ON Semiconductor, DePaul University

Jeffrey M. Cunningham, managing director, senior advisor, NACD

Kenneth Daly, president and CEO, NACD

Theodore L. Dysart, managing partner, Heidrick & Struggles

Robert S. Kaplan, Baker Foundation Professor of Leadership Development, Harvard Business School; director, Acorn System, Evergreen Energy

David Swinford, president and CEO, Pearl Meyer & Partners

Laura Unger, former SEC commissioner (1997-2002); director, Ambac Financial, CA, Inc., CIT Group; advisor to Promontory Financial Group

reflected in their decision making.”

Executive recruiters such as Dysart rely on data from a variety of sources to keep current on trends that could affect hiring. What’s been missing, however, is a view of how public company board directors are feeling about the economy and their industry. “At the end of the day, even the CEO has to go to the board to deploy capital and make an investment,” Dysart says. “Over time, the Board Confidence Index should become a leading indicator of what’s to come in other economic indicators. The decisions on where and how companies deploy capital begin in the boardroom.”

For directors, the opportunity to be informed about the opinions and mindsets of their peers

at companies of similar sizes and in the same or different industries will be beneficial for many reasons. Curtis Crawford, who serves or has served on numerous public company boards and runs a California-based leadership consulting company called XCEO, says directors have “a significant impact” on the economy.

“The reason I stressed ‘significant’ is because directors approve transactions that corporations make and they have a heavy influence on how those decisions are being shaped. So when a corporation decides to acquire or dispose of assets or to go global in their strategic thinking, that has a profound influence on the GDP and the economy.

“From my perspective as a director,” he

Devising the First BCI

The first step in creating the Board Confidence Index was to study what exists in the marketplace. Consumer and CEO confidence levels have been in existence for decades; more recent polls seek to measure the confidence or sentiments of such groups as credit managers, retirees, employment managers and investors to provide both a current snapshot and historical trends and, perhaps, indicate future behavior that could shape economic activity.

The two most widely known and cited confidence indices are conducted by The Conference Board, a nonprofit, non-partisan organization that has reported CEO confidence on a quarterly basis since 1976 and consumer confidence since 1968. Its widely reported results provide a useful gauge on the economic outlook of America’s top business executives and consumers. Each month, some 100 CEOs are asked their concerns for their business and their views on where the economy is headed. A reading above 50 indicates that the CEOs surveyed are more optimistic; below 50 indicates that they are pessimistic about the economic future. The survey asks and reveals their views on hiring, the reasons for layoffs, concerns about their particular industries and their short-term and long-term outlook on where the economy might be headed.

Since consumers account for two thirds of the

domestic spending in the United States, their expectations play a critical role in the contraction and expansion of the U.S. economy. These two indexes informed the methodology of the BCI so that comparisons could be drawn between the sectors: CEOs, consumers (of which, of course, CEOs and directors are a subset) and directors.

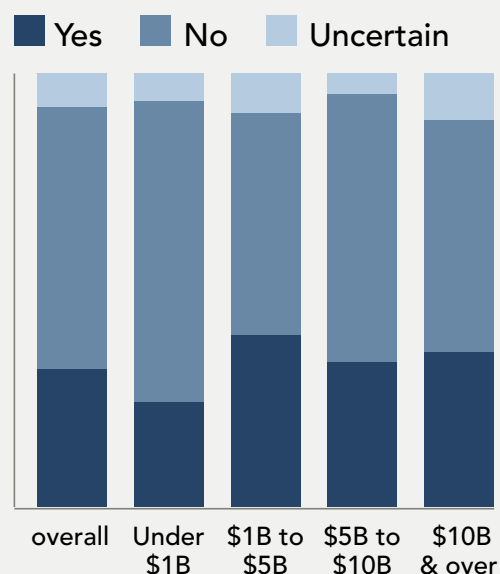
Based on five key indicators, the Board Confidence Index will provide a snapshot of the state of the economy from the boardroom’s perspective. During the month of August, 1,000 directors were asked to answer several questions. Per question, there were three reply options: Yes, No and Uncertain.

Assigned to each option is a point value: 100, 0, and 50, respectively. The point values are averaged for each question. Based on the scale, scores can be interpreted as follows: scores above 50 are positive about the state of the economy, scores around 50 are uncertain, and those below 50 are negative. Of the 1,000 directors asked by email to answer the survey, 155 responded.

NACD Directorship, in collaboration with Heidrick & Struggles and Pearl Meyer & Partners, plans to update and publish this index every quarter to provide directors with their peers’ perceptions of current business conditions.

—NACD Research

Are you in favor of Congress' proposed financial-system reform?



continues, “it would be helpful to learn how directors see the economy. We have a different perspective because of a strong sense of commitment to shareholder value—that’s what our charter is—to make sure that we’re striving to achieve shareholder value. We have fiduciary accountability, along with the responsibility to collaborate with management to produce the desired outcome...the opportunity to have the collective view of boards would be helpful.”

The expectation is that over time, the Board Confidence Index could portend future trends, because directors are on the frontline, informing and approving the corporate strategies that ultimately contribute to the expansion or contraction of our economy.

Beyond Confidence

In addition to measuring directors’ attitudes toward the economy, product pricing and profitability, the survey also asked respondents whether they were in favor of Congress’ proposed financial-system overhaul. Some 60 percent said they were not in favor, with 32 percent favorable and 8 percent uncertain. Nearly half of small companies believe

economic conditions have not improved over the last three months. The smallest companies also represented the largest group not in favor of financial-reform legislation.

Those who said they were not in favor of Dodd-Frank were asked to choose from a checklist about what concerned them most. “Say on pay,” the elimination of broker voting and proxy access topped the list of concerns. This is not surprising, since these are the issues that have been most frequently pushed to the top of regulatory and legislative agendas by reform-minded shareholders in the aftermath of the financial crisis. Swinford notes that each of these issues goes to the heart of how companies are run. “Directors worry about the relative freedom they have to run companies,” he observes. “If you couple more liberal proxy-access rules with the elimination of broker votes, you have more pressure on votes.”

Presumably, directors would answer this question differently in future surveys. At the time these questions were being asked in August, Dodd-Frank had passed, but the Securities and Exchange Commission had not yet approved the proxy-access rule, the first of several rules related specifically to corporate governance. As it turns out, the rule passed by the Commission was more favorable for corporations than was largely expected: for example, shareholders who want to nominate directors must own at least three percent of the company’s stock for

Table 1. Board Directors’ Confidence

Measure of Business Confidence	2010 Q3
Current Economic Conditions vs. 1 Year Ago	77
Current Economic Conditions vs. Last Quarter	42
Current Economic Conditions in Own Industry vs. 1 Year Ago	66
Current Economic Conditions in Own Industry vs. Last Quarter	45
Expectations for Own Industry, Next Quarter	48

Table 2. Current Conditions Compared with 1 Year Ago	2010 Q3	
	All Companies	77
under \$1B	73	
\$1B TO \$5B	83	
\$5B TO \$10B	74	
\$10B and over	80	

Table 3. Current Conditions Compared with Last Quarter	2010 Q3	
	All Companies	42
under \$1B	36	
\$1B TO \$5B	45	
\$5B TO \$10B	41	
\$10B and over	43	

Table 4. Current Conditions In Own Industry Compared with 1 Year Ago	2010 Q3	
	All Companies	66
under \$1B	69	
\$1B TO \$5B	62	
\$5B TO \$10B	67	
\$10B and over	64	

Table 5. Current Conditions In Own Industry Compared with Last Quarter	2010 Q3	
	All Companies	45
under \$1B	52	
\$1B TO \$5B	41	
\$5B TO \$10B	38	
\$10B and over	45	

Table 6. Expectations of Business Conditions in Own Industry Next Quarter	2010 Q3	
	All Companies	48
under \$1B	53	
\$1B TO \$5B	43	
\$5B TO \$10B	45	
\$10B and over	46	

a minimum of three years. Even so, Swinford thinks proxy access will continue to top the list of directors' concerns, at least through the next proxy season as the new rule plays itself out.

How the BCI Compares

Directors' perceptions mirror consumer perceptions, but differ from the opinions of CEOs.

The Conference Board Measure of CEO Confidence, which decreased in the first quarter of 2010, was unchanged in the second quarter. The measure remains at 62. (Like the BCI, a reading of more than 50 points reflects more positive than negative responses.) "CEOs' confidence held steady in the second quarter and expectations signal no change in the pace of economic growth in the coming months," said Lynn Franco, director of The Conference Board's Consumer Research Center. "The outlook for corporate profits remains optimistic, with almost half saying market demand growth will be the principal driving force."

Among the buying public, the University of Michigan's Consumer Sentiment Index and The Conference Board's Consumer Confidence Index are the most widely followed measures of U.S. consumer confidence. The Michigan index began as an annual survey in the late 1940s; the Conference Board launched its consumer index in 1967. The two indexes broadly measure the same concept—public confidence in the economy—but are based on different sets of questions and sometimes give conflicting signals.

Case in point: the month of August, which at the time this article was being written, was the most recent data available. The Michigan Index fell from 68.9 in July to 66.6 in August. The lack of confidence was not due to worries about the current economic environment—the economic conditions index increased from 78.3 to 78.4—but from an increasingly cautious outlook regarding the future. Michigan's economic outlook index fell from 62.9 to 59.1, its worst level since March 2009.

Meanwhile, The Conference Board's Consumer Confidence Index in August showed a "moderate" improvement from 51.0 in July to 53.5 in August. The TCB survey is based on a

representative sample of 5,000 U.S. households that were polled between August 1-24. Consumers' assessment of current conditions was less favorable, as employment concerns continue to weigh heavily on consumers' attitudes, said Franco: "Expectations about future business and labor market conditions have brightened somewhat, but overall, consumers remain apprehensive about the future. All in all, consumers are about as confident today as they were a year ago" when the index stood at 54.5.

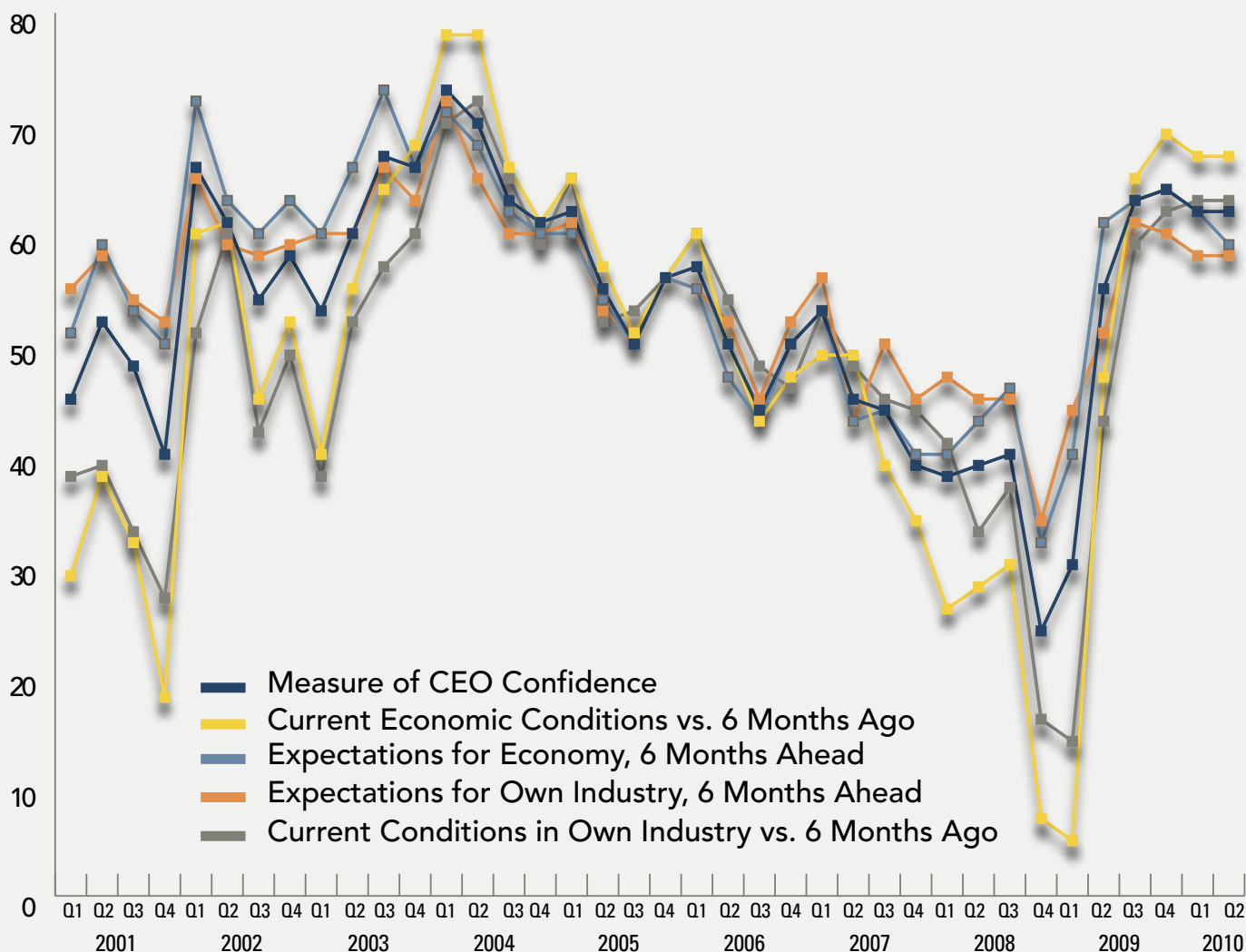
What needs to happen for boards to feel

confident enough to encourage their companies to spend some of the cash they have amassed, amid restructuring and increased productivity?

"Clarity about the rules of the game and enough incentives to get businesses to hire," said Crawford. "Our economy will only begin to expand again when we have put enough people to work in jobs with enough discretionary income that they begin to spend again." ■

This report was prepared by NACD Research.

CEO Confidence Survey Historical Data 2001-2010



SOURCE: The Conference Board