

Governance

Survey

What directors know about their companies: A McKinsey Survey

Corporate board members are more actively involved than they have been, and they are often—but not always—knowledgeable.

Web exclusive, March 2006

Boards of directors are becoming much more knowledgeable about and actively involved in their companies' core performance and valuecreating activities, according to the executives who responded to the latest *McKinsey Quarterly* survey.¹ However, in one controversial area of corporate governance—compensating executives with stock options and bonuses tied to earnings growth—these more active board members have effected relatively little change.

In a previous survey, conducted in early 2005, directors expressed an eagerness to spend more time on topics such as their companies' talent, skills, and current performance.² Directors appear to have made significant progress: nearly two-thirds of all respondents to the current survey say that boards have become more actively involved in strategy, finance, and other core areas of corporate performance and in value creation than they were five years ago. Further, the proportion of boards that are more active varies little from region to region, even though reforms in corporate governance regulation have differed significantly around the world. Larger companies and publicly held ones are somewhat more likely to have more active boards (Exhibit 1).

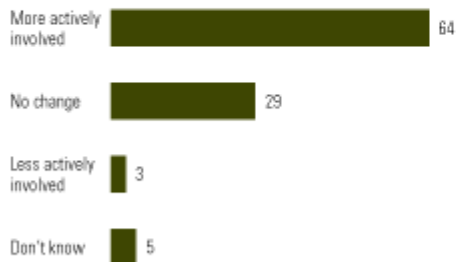
EXHIBIT 1

Is your board more involved?

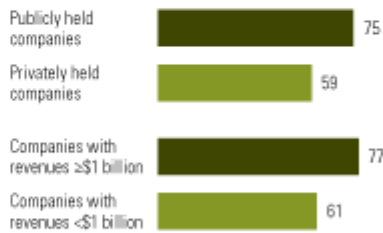
% of respondents¹

How actively involved is your company's board of directors in the core areas of company performance and value creation compared with 5 years ago?

Overall²



By company type, respondents who answered "more"/"substantially more" involved, %



¹All data weighted by GDP of constituent countries to adjust for differences in response rates from various regions.

²Figures do not sum to 100%, because of rounding.

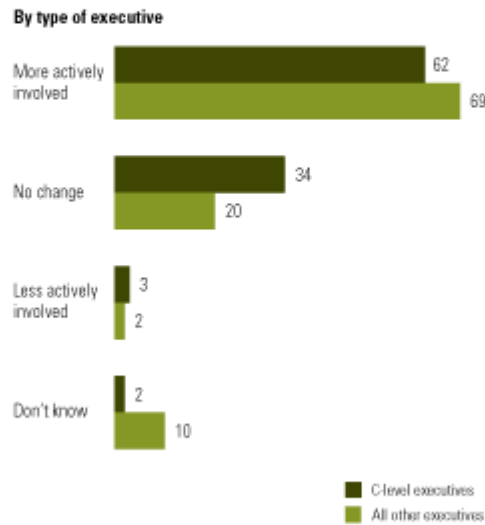
Notably, CEOs, CFOs, and other "C-level" executives, who have the closest contact with the board—indeed, many are on it—see less dramatic change in the directors' roles in the past five years than other executives do: a third say that no change has taken place in the board's level of activity, a view held by only 20 percent of other executives (Exhibit 2). In addition, C-level executives are less likely than others to say that board members fully understand their companies' strategies, financial position, and risks (Exhibit 3). Although the survey did not probe this issue more deeply, several possible reasons could explain the disparity. One might be a difference in perceptions between C-level executives, who may think that boards were more actively involved in the past, and other respondents. It is also possible that the changes are more rhetoric than reality.

EXHIBIT 2

Differing perspectives on the board

% of respondents¹

How actively involved is your company's board of directors in the core areas of company performance and value creation compared with 5 years ago?



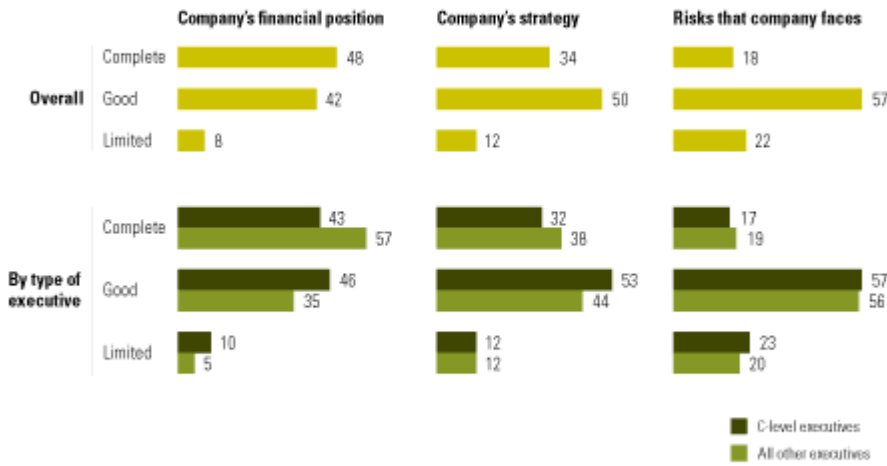
¹ All data weighted by GDP of constituent countries to adjust for differences in response rates from various regions; figures do not sum to 100%, because of rounding.

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EXHIBIT 3

The knowledgeable and the not so knowledgeable

% of respondents who describe board's understanding of given issue as 'complete,' 'good,' or 'limited'¹



¹ All data weighted by GDP of constituent countries to adjust for differences in response rates from various regions; figures do not sum to 100%, because respondents who answered "no understanding" or "don't know" are not shown.

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Even so, executives at all levels say that directors have made real progress in learning more about their companies' strategies, financial position, and risks. Last year, 63 percent of board members said they had a good or complete understanding of the risks facing their companies; this year, 75 percent of respondents say so. On the board's understanding of corporate strategy, the share reporting a solid understanding has risen to 84 percent, from 73 percent. Nine out of ten respondents to the current survey say that their boards have a good or complete understanding of the financial position of their companies.

The biggest knowledge gap for boards continues to be about risk: while 34 percent of the respondents say that the directors have a complete knowledge of strategy, only 18 percent credit them with the same command of risk. One year ago, the figure was 11 percent in both categories. Some 48 percent of the respondents say that their boards have a complete grasp of their companies' finances.

EXHIBIT 4

Few have abandoned pay for performance

% of respondents¹


Regarding the pay of top executives, in the past 5 years has your company decreased the use of pay-for-performance approaches?



¹ All data weighted by GDP of constituent countries to adjust for differences in response rates from various regions; figures do not sum to 100%, because of rounding.

² Bermuda, Canada, Greenland, United States.

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Directors don't seem to be putting their newfound knowledge to work by addressing controversial pay practices such as stock options, stock grants, and bonuses tied to earnings growth. Twothirds of the executives say that their companies' use of such pay practices has not diminished in the past five years. Companies in North America are the least likely to have changed: only 15 percent did so. Companies in the developed countries of the Asia-Pacific region, at 25 percent, are the likeliest to have changed pay practices (Exhibit 4). 

Notes

¹*The McKinsey Quarterly* conducted the survey in February 2006 and received 1,468 responses from a worldwide representative sample of business executives from publicly and privately held businesses across a full range of industries.

²Robert F. Felton and Pamela Keenan Fritz, "The view from the boardroom," *The McKinsey Quarterly*, 2005 special edition: Value and performance, pp. 48-61.