



Survey of investors and professional financial advisors on corporate governance and reputation issues

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From August 31 to September 4, 2007, FTI and FD conducted an online survey of professional financial advisors and high-net-worth investors (people with \$1 million of investable assets or more) to determine their perspectives on a number of issues relating to corporate governance and corporate reputation.

One hundred financial advisors and 102 high-net-worth investors responded to the survey. The responses to our questions make it clear that corporations still have significant strides to make in reassuring investors and their advisors about the effectiveness and quality of corporate governance and whether these practices are appropriately safeguarding corporate reputation. At the same time, both of the surveyed groups consider sound corporate governance and a strong corporate reputation to be crucial in the creation of shareholder value. We believe the most effective management teams and boards will therefore address this head on and ensure they are doing everything possible to strengthen both corporate governance and reputation, as the valuation of the businesses they are leading in large part depends on this.

Boards should be directly involved in the communications around significant events. Most financial advisors and high-net-worth investors believe that the board should be involved in the communications around high-stakes issues that directly affect the reputation and fortunes of the company, especially when it comes to issues such as a CEO resignation or a crisis (see Table 1). We believe this is important for directors as the stewards of a company, because over one-half of the financial advisors and high-net-worth investors say that a company can lose in excess of 30% of its share value as a result of a highly publicized crisis.

Table 1: Appropriate circumstances for board involvement
(n=100/102)

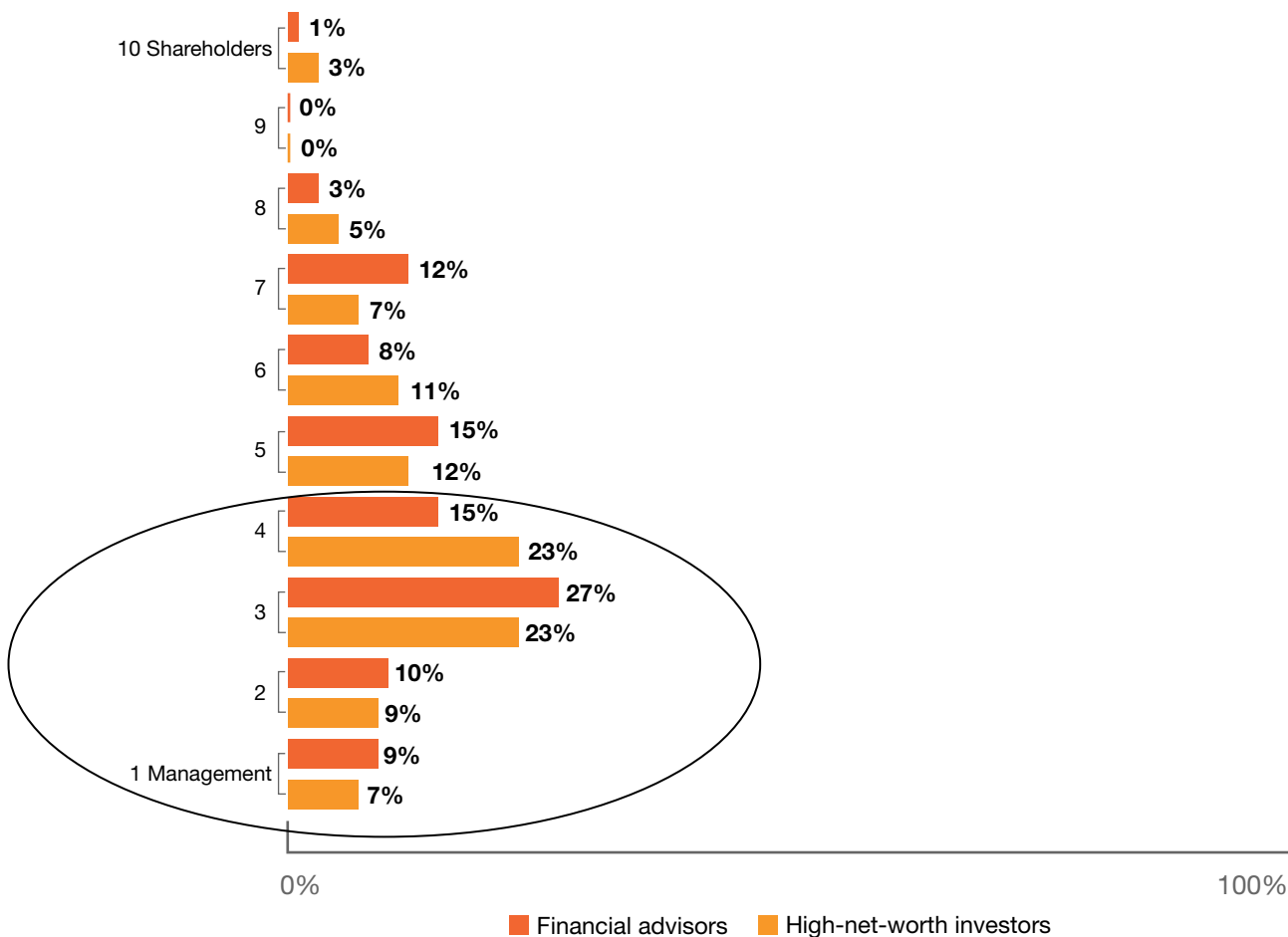
	Financial Advisors	High-Net-Worth Investors
CEO Resignation	83%	83%
Crisis	61%	58%
Executive Compensation Issue	57%	46%
Merger or Acquisition	45%	47%
Earnings or Other Material Event	24%	12%



Whose interests does the board represent?

There is a clear perception that the board primarily serves management, rather than shareholders. Majorities (61% of financial advisors; 62% of high-net-worth investors) say that boards tend to operate in the interests of management, rather than those of shareholders. Since boards are perceived to have a material impact on the stock price (56% of financial advisors and 41% of high-net-worth investors say that a board accounts for more than 10% of a company’s share value), we believe it’s imperative that boards resolve this misalignment in perception.

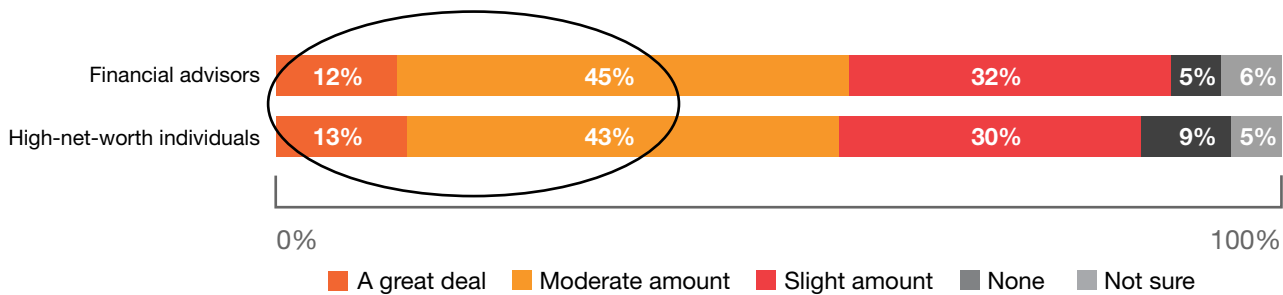
Question: Using the 10-point scale below, please indicate whether you think the typical board of directors today represents primarily the interests of management or the interests of shareholders.



➔ **Impact of Sarbanes-Oxley on corporate governance**

Sarbox is viewed as having limited effectiveness in driving improved corporate governance. Despite the billions of dollars of expense and man-hours spent on compliance with Sarbanes-Oxley, a relatively small percentage of respondents (13% of financial advisors and 12% of high-net-worth investors) believes that corporate governance practices have improved “a great deal” since the passage of Sarbanes-Oxley. While a full 57% of financial advisors and 56% of high-net-worth investors say that corporate governance has improved at least a moderate amount since Sarbox, that is still not a ringing endorsement, and indicates that investors could stand to have greater confidence in the way the corporations govern themselves. These findings track with a survey of institutional investors conducted by FD in 2002 right after Sarbox’s passage, which showed that a plurality of respondents at the time (40%) did not think the bill’s provisions were enough to significantly strengthen corporate accountability.

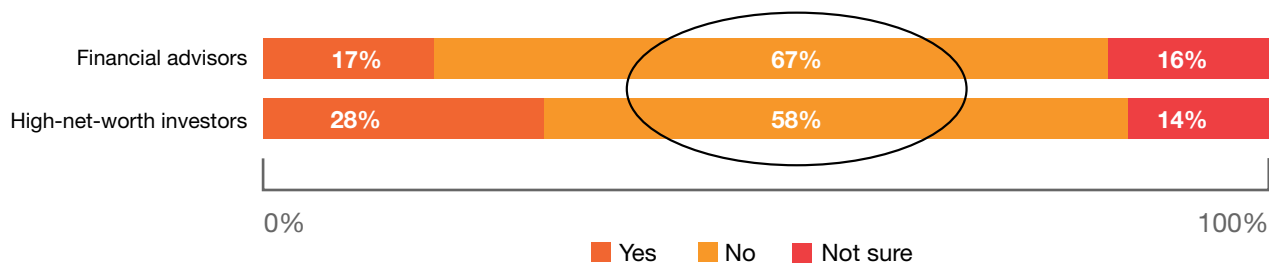
Question: Still thinking about corporate governance, how much, if at all, would you say corporate governance has improved since the advent of Sarbanes-Oxley?



→ The public and corporate governance

An information vacuum about governance practices exists. While governance is considered vital to both a company's reputation and the success of a company's board, both financial advisors and high-net-worth investors strongly believe that companies do not provide enough information to the public about their governance practices (67% of financial advisors; 58% of high-net-worth investors). This finding, along with boards' perceived fealty to management rather than shareholders, suggests that boards could do much more to reassure shareholders that they are acting in their best interests.

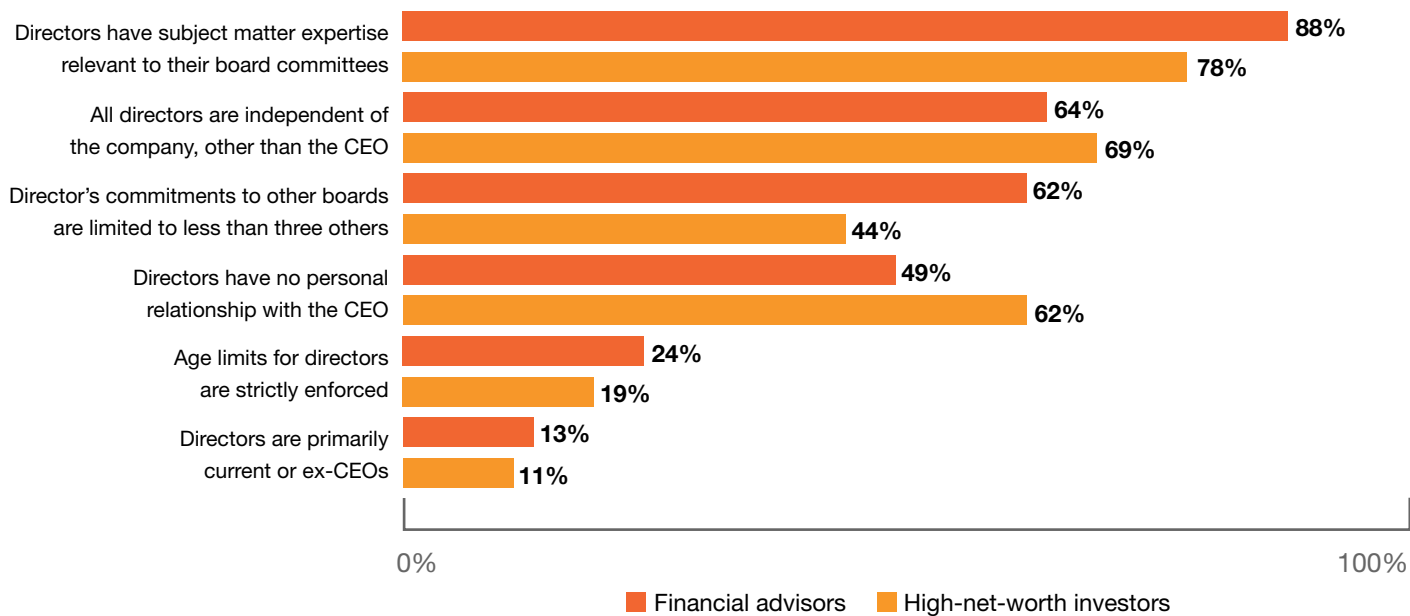
Question: In general, do you think companies provide enough information about their corporate governance practices to the public? **ASKED OF FINANCIAL ADVISORS:** In general, do you think companies provide enough information about their corporate governance practices to investment professionals?



→ An effective board of directors

Expertise and independence are the most prized commodities. Both financial advisors and high-net-worth investors cite expertise relevant to a director’s committee assignments as the primary characteristic that most determines an effective board member (88% of financial advisors; 78% of high-net-worth investors). Beyond that, high-net-worth investors value independence from both the company and the CEO as very important. Financial advisors also value independence from the company, but are more concerned that directors not spread themselves too thin than they are about the relationship with the CEO. Both segments pay far less attention to the age of board members and whether or not the board member is either a sitting or former CEO. Clearly, investors are looking for qualifications and experience, and these factors are far more important to them than what kind of title a board member may currently or formerly enjoy.

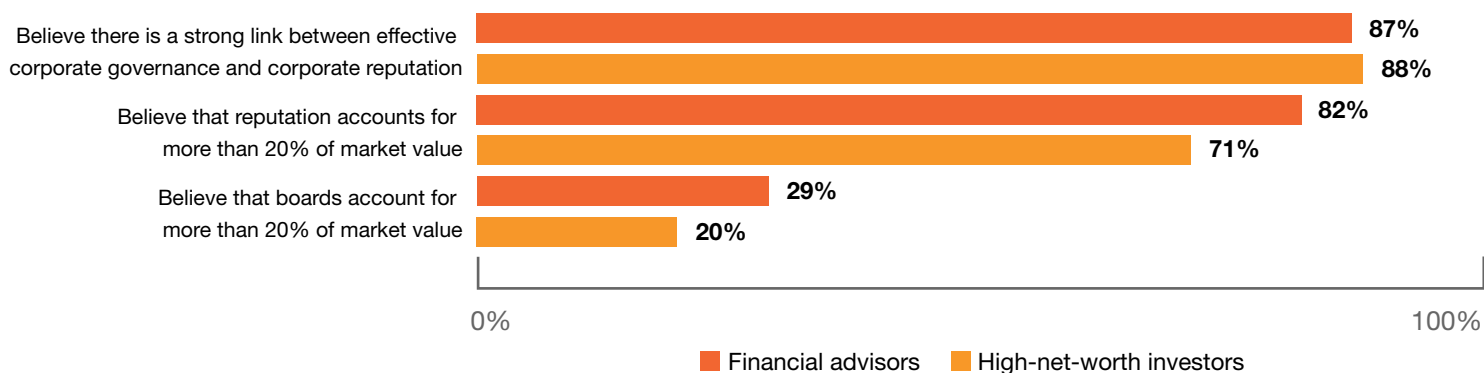
Question: Which of the following do you associate with an effective board of directors? Please select all that apply.



→ Effective corporate governance and corporate reputation

A strong link is seen between effective governance and corporate reputation. Most advisors (87%) and high-net-worth investors (88%) report that there is a link between effective corporate governance and a company's reputation. Paradoxically, both financial advisors and high-net-worth investors ascribe significantly more market value to reputation than they do to board quality. 82% and 71%, respectively, of financial advisors and high-net-worth investors believe reputation accounts for more than 20% of market value, compared to only 29% of financial advisors and 20% of high-net-worth investors who think boards account for more than 20% of market value. Our conjecture is that a company – and therefore its corporate reputation – is consistently in the public eye while, until recently, boards have maintained a low profile and have operated behind the scenes.

We believe boards have the potential to drive stock market value, but it is predicated upon boards convincing investors that their allegiance is shifting in favor of shareholders.



**What can be done to enhance perceptions of good governance and strengthen the perception of boards of directors?**

There are a variety of ways in which companies can communicate more forcefully about what they are doing to improve corporate governance and instill confidence that the board is operating in the interests of shareholders.

FD's recommendations are listed below:

- As independence is so highly valued by survey participants, directors should put in place mechanisms to directly assess the attitudes of investors, including their perceptions of management and of the company's strategy. Institutional research coverage of the company provides one measure of investors' perceptions; third-party perception surveys, if properly structured and executed, can complement such analyst research, helping boards understand how buy-side investors, retail investors and other stakeholders are aligned with management and the direction of the company. Findings can be critical in redirecting management and the board in terms of strategy, execution and communication.
- For directors' biographies listed on the corporate website and in corporate filings, include a paragraph for each director stating his or her track record in creating shareholder or enterprise value for a current or prior company/organization. Also consider a quote from each director that states their point of view about serving as a director and their understanding of the need to work in the shareholders' interests. Finally, cite the stockholdings of directors to demonstrate alignment with shareholders and commitment to long-term value creation.
- Create a set of governance principles that are posted on the company's corporate website that make it clear that the intention is to have a board of directors that works first and foremost in the interest of the shareholders.
- On the corporate website, describe each board committee in some detail, and link its activities to specific objectives that support the creation of shareholder value.
- Consider highlighting board members in the company annual report – specifically, what role they play on the board, their philosophy of board service and what value they believe their involvement brings to the company, its board, and its key stakeholders.

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