

EXECUTIVE SUMMARY

Emerging Company Boards Study

Comprehensive Analysis of Emerging Company Boards

What are the most critical leadership and governance issues facing Emerging Company Boards? What are the perceptions and practices of directors? Spencer Stuart's study uncovers what emerging company board directors in the technology and life science industries are thinking and what leading practices are shaping corporate governance today.

Since the passage of Sarbanes-Oxley, boards throughout the country are going through tremendous "self-scrutiny" and examining whether they have a sufficient number of independent executives, as well as the proper expertise for their business needs. Spencer Stuart, an executive search firm that specializes in Board placements, recently conducted a survey of CEOs, Chairmen and other Board Members of "Emerging Companies." Emerging Companies are defined as companies under \$250 Million in revenue in the Hi-Tech and Life Sciences sectors.

Personal Considerations

When board members were asked about the obstacles to serving on a board, many stated that liability was too much of a risk. *"The undercompensation and increasing work load and liability are becoming big issues voiced by all board members of emerging companies,"* said one executive.

Many directors also stated that boards now take up too much time to make it worth their time to serve – 65% spend anywhere from 11 to 25 hours or greater on board matters *each month*. Insufficient compensation is becoming an increasing concern. 46% receive a cash retainer and 49% receive cash for meeting fees. Yet 69% believe that a cash retainer is necessary to attract and retain new directors. And 75% believe that that meeting fees are necessary to attract and retain new directors.

Currently, the most common compensation packages are comprised of (1) Options only, (2) Options plus Meeting fees, or (3) Options plus Cash retainer. However, the package most recommended to attract and retain new directors in-

cludes all three: Options plus Meeting fees plus Cash retainer.

Said one survey respondent: *"Board governance continues to move through a transitional period of more accountability. I view this as a good trend and one that will strengthen company leadership effectiveness to the benefit of all shareholders. I am also concerned about the practical impact of new regulation, both from a personal liability perspective and from the concern that in order to comply with these regulations and protect board members from liability, excessive time and energy will be placed on form over substance. If this happens, boards may become less effective in protecting the interests of stakeholders than they were before Sarbanes-Oxley."*

Steps taken on Corporate Governance:

<u>Boards Are Reshaping Their Governance Practices</u>	<u>Complete or In Review</u>
Increase Clarity of Board Role Descriptions or Committee Charters	82%
Review Board Member Appointment	66%
Increase Proportion of Independent Board Members	56%
Change Board Composition to Eliminate Potential Conflicts of Interest	49%
Encourage Less Engaged Board Members to Step Down	34%
Remove VC or Private Equity Investors	23%
Reduce Board Size	15%
Move Inside Members Off the Board	14%

Good Governance

Even more striking was the fact that many boards have taken dramatic steps on corporate governance. The majority of respondents indicate that the process to reshape their board's governance practices is "completed" or "in review".

"Boards need to spend much more time this year implementing governance principles (for Sarbanes-Oxley and to comply with new listing exchange recommendations) and processes to review Board effectiveness."

A large majority (77%) hold regularly scheduled Executive Sessions that exclude company management. This is another indicator that *independence is becoming increasingly important—and has been put into practice as well*. We found that the overwhelming majority (95%) did not believe that other directors were sitting on an excessive number of boards.

When it comes to adding new board members, certain functional expertise—especially Audit & Control and Strategy—is considered "very important", with least demand in Operations and HR.

Functional Expertise considered "very important" in new board members:

Audit & Control	73%	Marketing	36%
Strategy	63%	Sales	31%
Science/Tech	39%	Operations	13%
Finance	38%	HR	0%

Directors were also asked about what committees they currently sit on and expect to hold in the year. Interestingly, while a significant percentage sat on the Audit (37%), Compensation (40%), Governance (28%), and Nominations (18%) committees, a much smaller percentage of those currently sitting on the Governance committee expect to hold that seat in the coming year. This could be related to Sarbanes-Oxley, implying that directors are more reluctant to take a leadership role with respect to corporate governance, especially as it relates to personal liability.

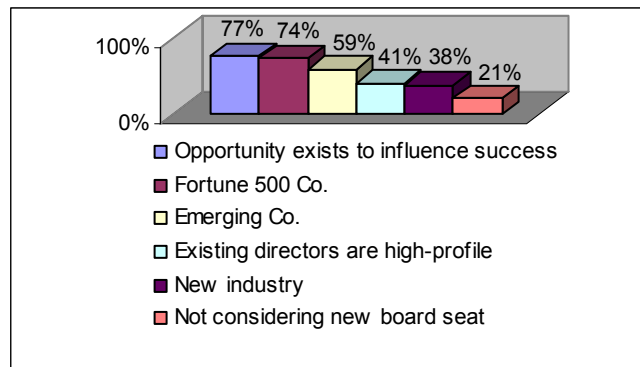
Which committees do you currently sit on or expect to sit on in the coming year?

	Hold Currently	Hold Currently & Expect to Hold
Audit	37%	26%
Compensation	40%	23%
Governance	28%	7%
Nominations	19%	12%

When it comes to CEO succession planning, 47% indicated that an informal process was in place. 16% indicated that they review they formally review a succession plan more than once a year, and over 16% of respondents replied that the board was not even involved in the succession planning process.

Lastly, when directors were asked what kind of board would be most attractive—if indeed they were considering an additional board appointment—the majority responded that they'd look for board seat with a Fortune 500 company or with a board where they'd have to opportunity to influence and help shape company success.

If joining an additional board, what kind would be most attractive to you?



Trends

Clearly the reactions to the recent Sarbanes-Oxley bill have caused board members to take their board obligations more seriously. But how will this disconnect between concerns over liability and time verses increased need for qualified board members be resolved? Based on study findings and conversations with a number of direc-

tors sitting on emerging company boards, we have found a number of emerging trends that should help to correct this market imbalance:

- **Increased Interest in Retired Executives**

There are many CEOs and CFOs who are now retired that have the capacity to sit on four to five boards. Particularly in the technology sector, the environment for raising money and meeting investor expectations is very challenging. Many former CEOs and CFOs now prefer serving as “professional” board members versus running a company or being the top financial officer. Since Sarbanes-Oxley, boards are increasingly sensitive to recruiting new members who can commit the necessary time.

- **Substance over Sizzle**

In the late '90s, companies wanted “marquee” names on their boards. These were frequently sitting CEOs of high valuation companies. Now, boards seek those executives of companies who have experienced longer term track records of success. Even a number two executive who was “in the engine room” of a successful company is more desirable than a CEO of a fallen star.

- **Increased Compensation**

The data is mostly anecdotal at this stage, but all boards are now examining the compensation package necessary to recruit new members. In some cases, committee members (particularly audit) receive a premium. Committee chairs also are increasingly receiving compensation premiums due to the increased time commitments. Additional information on changes in compensation and other trends related to young, venture-backed, rapidly growing companies will be available in Spencer Stuart's *2003 Emerging Company Board Index*. The index will be published in September 2003.

Why Sit on a Board?

The intellectual challenge and stimulation of learning a new business is typically one of the key attractions to potential board members, but board members also want the satisfaction of making an impact while serving in the capacity as Director.

Many of the directors FORTUNE interviewed for 2002 article on corporate governance acknowledged that “all the pressure and scrutiny has an upside too: They are getting better at their jobs.” Also, “for some directors getting a company through a rough time can end up feeling like a mark of accomplishment.”*

“Because of increased board and committee workload, most of the boards that I am on will increase in size during the next year.”

Compensation is further down the list, yet additional remuneration is still an incentive. Retainers are attractive, whether found in the form of stock options, grants, and/or cash. Meeting fees are typically provided as well.

About Spencer Stuart

Spencer Stuart is the foremost privately held, global executive search firm, spanning over 50 offices in 25 countries. Since 1956, we have been providing select clients with a range of human capital solutions, including senior-level executive search, board director appointments, strategic leadership services and middle-management recruiting. We conduct nearly 4,000 assignments each year, partnering effectively with clients ranging from the Fortune 5000, to mid-cap, to emerging growth companies across a broad range of industries and sectors. Widely regarded as the firm of choice for CEO, board director and other top-level executive searches, our worldwide consultants have the judgment, insight and expertise to find the ideal fit for each company's unique circumstances and business goals.