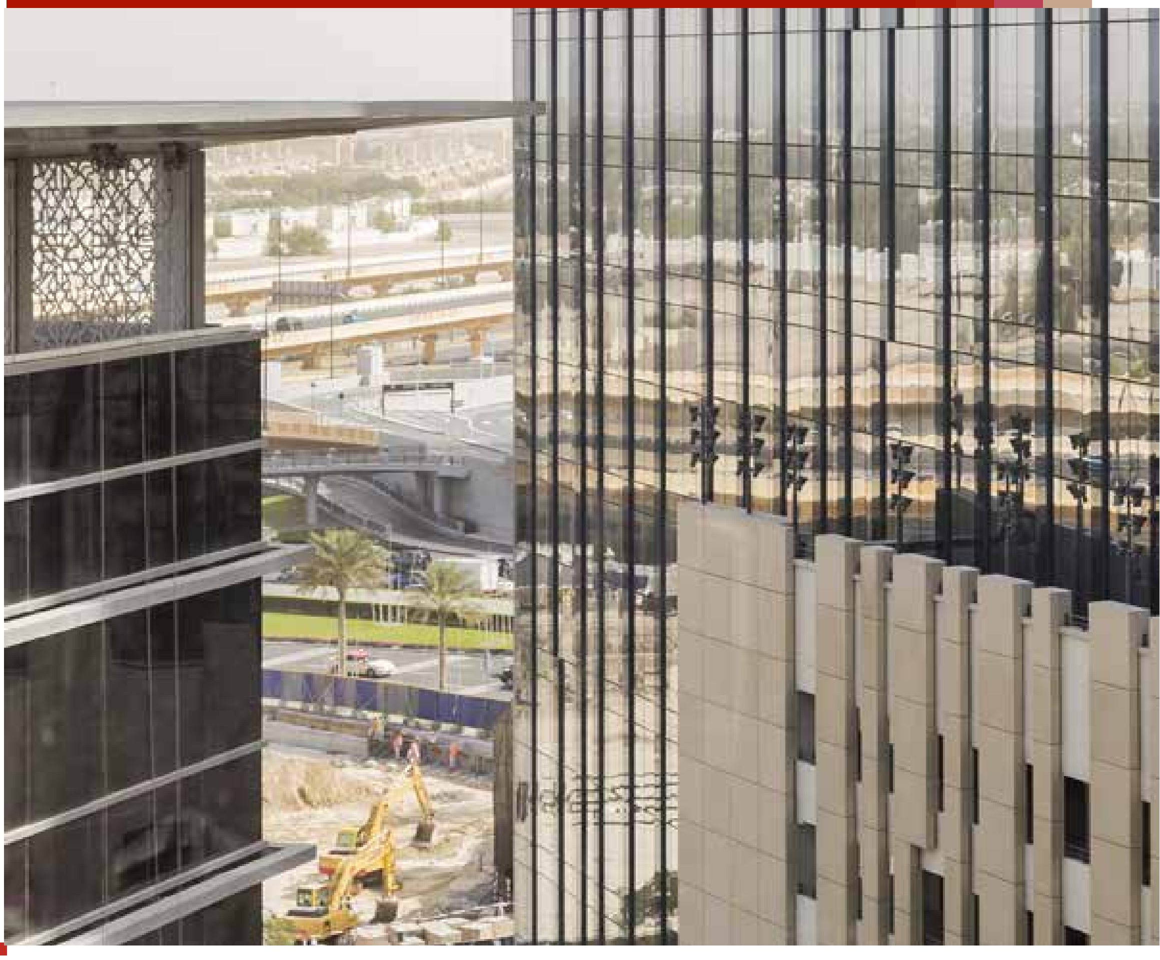
www.pwc.ru/boardsurvey

25 years in Russia

Megatrends on boards's agenda

Russian boards survey 2014

Technological breakthroughs and the shift in global economic power attract the attention of Russian boards



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Executive summary

"The world is changing at a breathtaking pace. Never before has (r)evolution occurred in such short periods of time. Market dominance can be lost to completely new entrants and leaders who do not understand and listen to their stakeholders and who lack the willingness and ability to change will be passed by, as their markets and customers move without them."

Blair Sheppard
Strategy and Leadership
PwC International

"Directors must set the tone from the top. However, in Russia the state plays a very large role. State controlled companies are normally less flexible and adaptive to trends than private sector companies. To address the challenges and opportunities raised by the megatrends, should the government step up?"

David Gray
Managing Partner
PwC Russia

We live in a world of uncertainty and it seems we often struggle to understand this. The following abstract from *The Economist's* "Megachange: The World in 2050" nicely demonstrates the truth of this statement:

"History is littered with prophecies that turned out to be utterly wrong, as Dan Gardner damningly documents in his book Future Babble. 'It is as certain as anything in politics can be, that the frontiers of our modern national states are finally drawn,' wrote a British journalist, H.N. Brailsford, in 1914. 'My own belief is that there will be no more wars among the six Great Powers.' Soon afterwards the First World War broke out. 'I expect to see the stock market a good deal higher within a few months,' forecast Irving Fisher, an American economist, a week before the 1929 crash."

"Yet it is still worth having a guess," – reckon the authors of the said publication. Indeed, the quality of thinking that boards devote to issues such as megatrends may be a critical factor in identifying which companies will evolve and thrive and which will end up in the corporate graveyard.

"There are several key trends acting together," – notes Blair Sheppard (Strategy and Leadership, PwC) – *"They are inescapable and they are here now. Successful organisations will be the ones who can adapt to these trends and discover how to treat them as opportunities."*

PwC has identified five hot global megatrends:

- Technological breakthroughs
- Shift in global economic power
- Climate change and resource scarcity
- Demographical shifts
- Accelerating urbanization

Nowadays, five hot megatrends include:

Technological breakthroughs
Shift in global economic power
Climate change and resource scarcity
Demographical shifts
Accelerating urbanisation

We invited members of Russian boards to participate in the third annual Russian boards survey to review the importance of these megatrends and to reflect on how their companies can adapt and thrive in such an environment of global change. Here are some of the survey's key findings and topics for further discussion:

- We are witnessing how once-emerging concerns are rapidly becoming hot topics. Our respondents tell us that **megatrends matter**, with **technological breakthroughs** and the on-going **shift in global economic power** being perceived as the most influential of these trends.
- Although **climate change and resource scarcity** is globally the leading concern, interestingly, it does **not** currently rate as a hot topic for most Russian boards.
- With both **risks and opportunities seen**, directors want their boards to dedicate more time and focus to considering megatrends and their possible implications on their companies' strategies.
- It is clear that the first thing that the boards must do is to better understand megatrends. A sustainable approach means putting in place systems to monitor changing conditions and related risks, and seeking the best ways to address them. In response to megatrends, boards may seek to penetrate **new markets**, consider **innovation** strategies and prepare themselves to **diversify** products / services, focus more on the **sustainability** and **corporate social responsibility** issues, or get more engaged in strategic **human capital** issues.
- Boards continue to prioritise **executive oversight** and **compensation** as topics. Indeed, in the present context, ensuring succession planning and bringing executive motivation in line with a company's strategic objectives and long-term performance are absolutely crucial.
- Meanwhile, key trends in Russian boardrooms are: (i) directors' time commitment is on the rise; (ii) directors want board meetings to be less formal and to include more open discussions; (iii) board evaluations are on track to move from form to substance; (iv) boards continue facing a shortage of skilled directors; (v) sitting on a board is not about money, but about finding an interesting and dynamic environment – something that the challenges around megatrends promise to ensure.

While focusing on Russian boards, for the purposes of benchmarking against international best practices, we will also refer in this report to the Annual Corporate Director Survey conducted by PwC US in 2013[1].

We would like to thank all respondents for their contributions to this survey and the insights they have provided regarding boardroom activities. If you would like to discuss any of the matters raised in this survey, please feel free to contact us.

[1] PwC's Annual Corporate Director Survey: Boards confront an evolving landscape. 2013. www.pwc.com/us/en/corporate-governance/annual-corporate-directors-survey/index.jhtml

65% of our respondents believe that megatrends have a material impact on their companies' business, 28% are still in doubt, and only 7% claim that their companies are not visibly affected by megatrends

Boards and megatrends

Megatrends are an increasingly common topic of conversation, but not many feel comfortable in their level of understanding of the substance of these concepts or with explaining their possible implications for business.

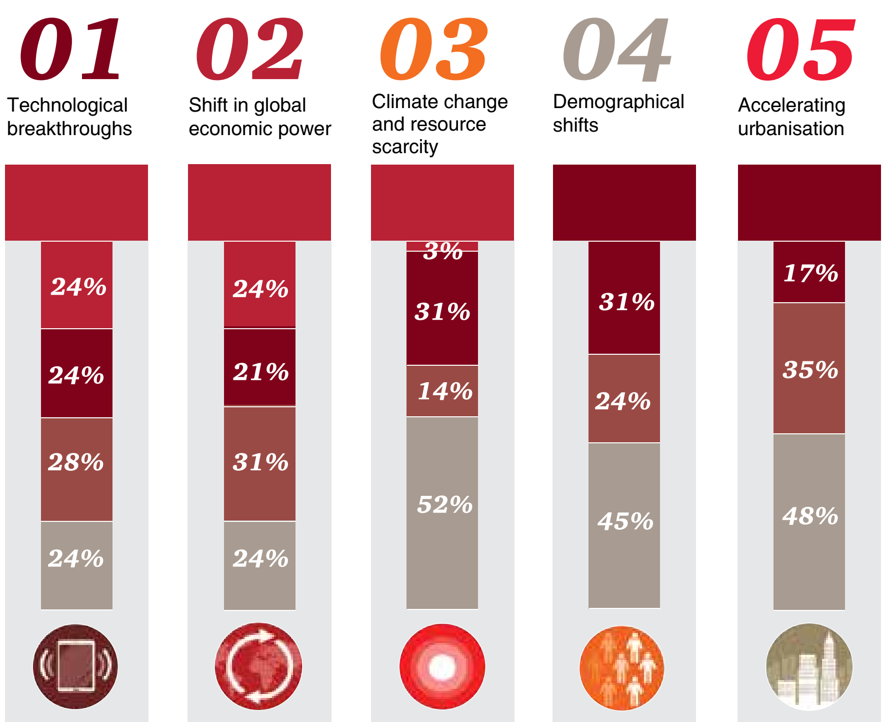
The Megatrends framework is an opportunity to cut through the noise and complexity to help make sense of this changing world. Megatrends are an inroad to having a more strategic and structured conversation that translates the big shifts in the world into meaningful opportunities and risks for our clients right now.

Megatrends refer to the global trends that we observe to be having a major influence on the economy today; trends that we believe will still be important over the next decade, and permeate all sectors of the economy and society.

In this survey, we have focused on how Russian board members perceive and address these megatrends in the context of their companies' business.

How do directors feel about megatrends?

Firstly, **65%** of our respondents believe that **megatrends have a material impact on their companies' business here and now**, 28% are still in doubt, but only 7% claim that their companies are not visibly affected by megatrends.



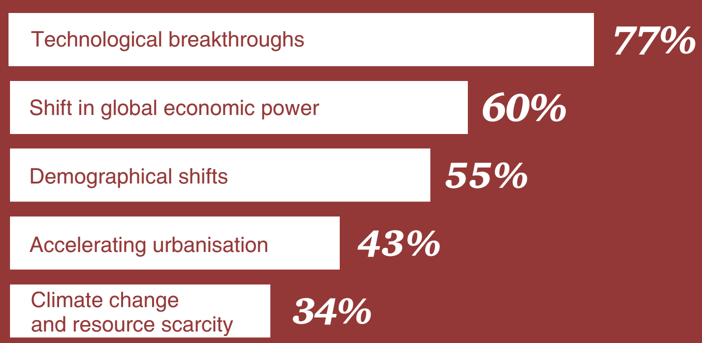
According to our respondents, the most influential megatrends in the long-term are technological breakthroughs and shift in global economic power. For both, **76%** of respondents see these megatrends as having a significant impact on their companies.

Next come climate change and resource scarcity and demographical shifts. However, even accelerating urbanisation, the megatrend considered least impactful by Russian directors, is still viewed as at least significant by more than half of our respondents. It is clear that our respondents are far from relaxed about the likely impact of megatrends on their businesses.

It is worth noting that directors' opinions on this topic are very similar to those of CEOs of Russian companies surveyed as part of PwC Annual Global CEO Survey.

Russian CEOs

Please rank the top three global trends from the following list, which you believe will transform your business the most over the next five years?

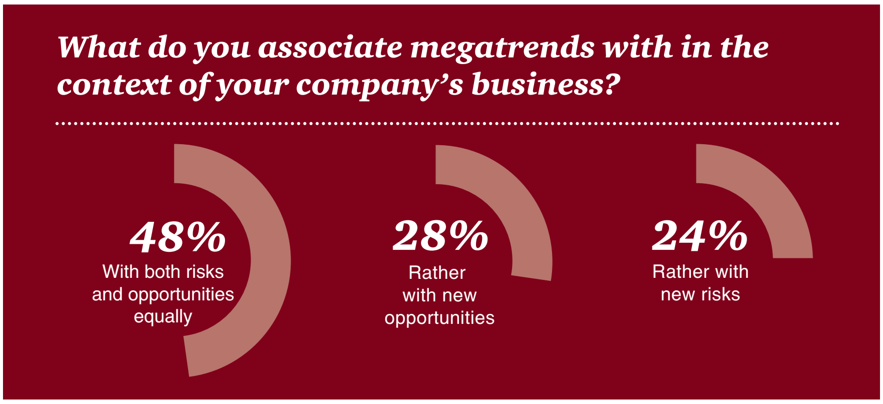


Source: PwC 17th Annual Global CEO Survey

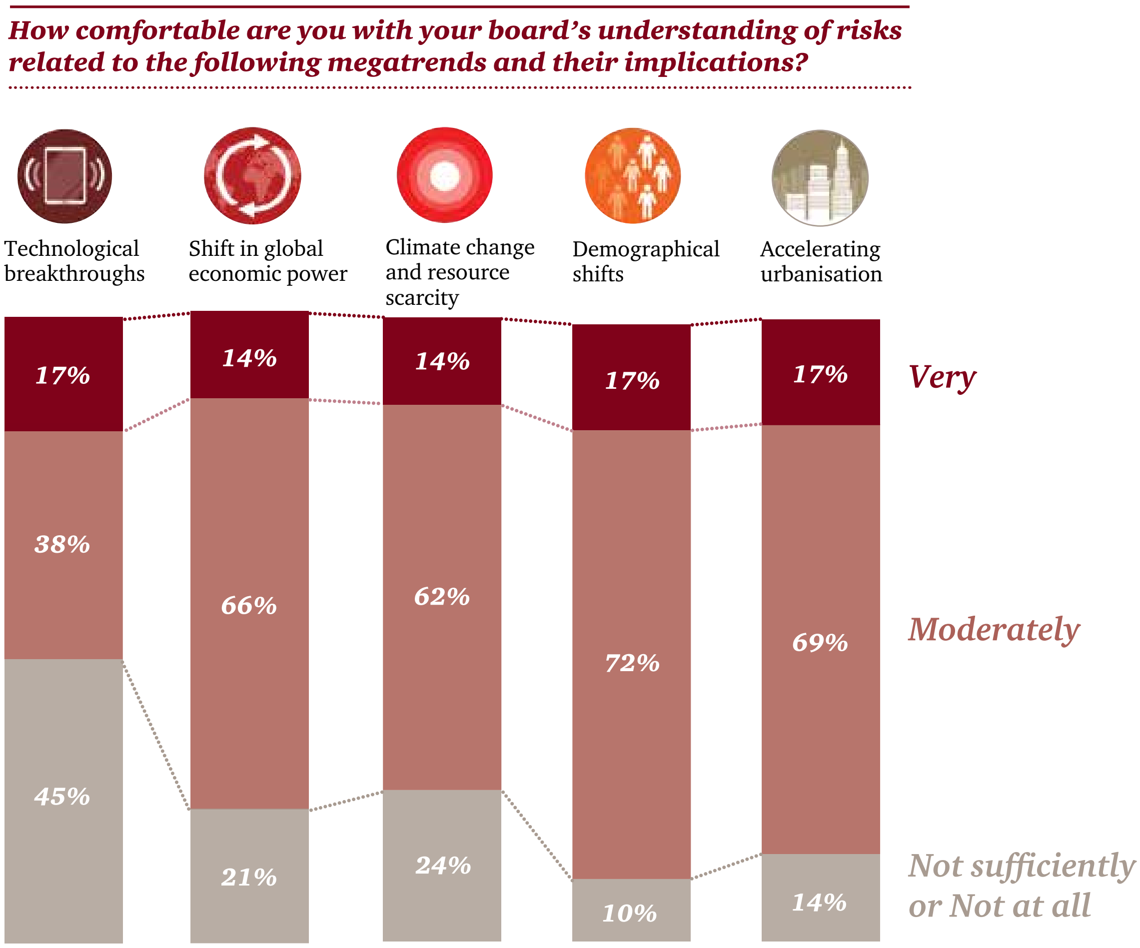
Both risks and opportunities are visible

The effects of megatrends are inescapable as they are acting together to shape the world we all live and work in. Successful businesses will be those who can adapt to megatrends and discover how to deal effectively with the threats they pose while also maximising on the opportunities they generate.

For instance, **48%** of directors believe that megatrends present **both risks and opportunities equally** in the context of their companies' business. Also, 28% of board members perceive megatrends as new opportunities, and nearly the same number of directors (24%) tends to associate megatrends rather with new risks.



Meanwhile, according to the survey results, most directors do not appear to be very comfortable with their boards' understanding of risks related to megatrends, and they are least comfortable with their boards' understanding of risks related to technological breakthroughs.



Two big questions arise:

1) If megatrends present risks – How do you mitigate the risks?

2) If megatrends present opportunities – How do you grab those opportunities?

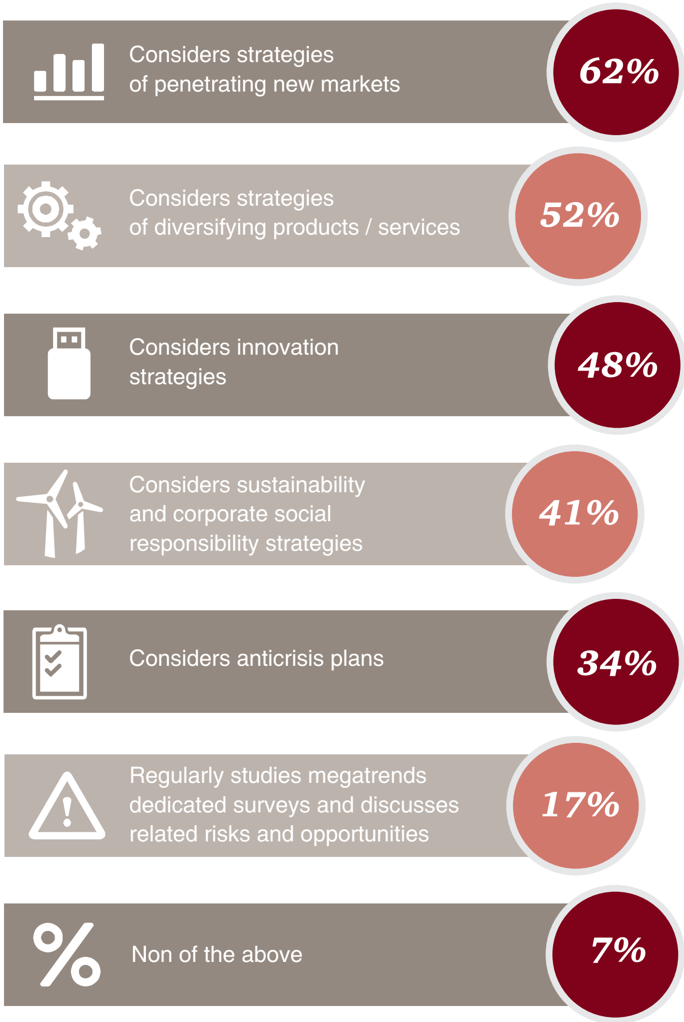
What are key megatrends and how do boards address them?

According to our respondents, only **17%** of boards study surveys on megatrends and **discuss related risks and opportunities** on a regular basis, which is perhaps not surprising as **41%** of directors express their dissatisfaction with the provision of such surveys to their companies' boards.

However, the picture is complicated as most boards do consider certain strategies to respond to particular megatrends that are of concern for them.

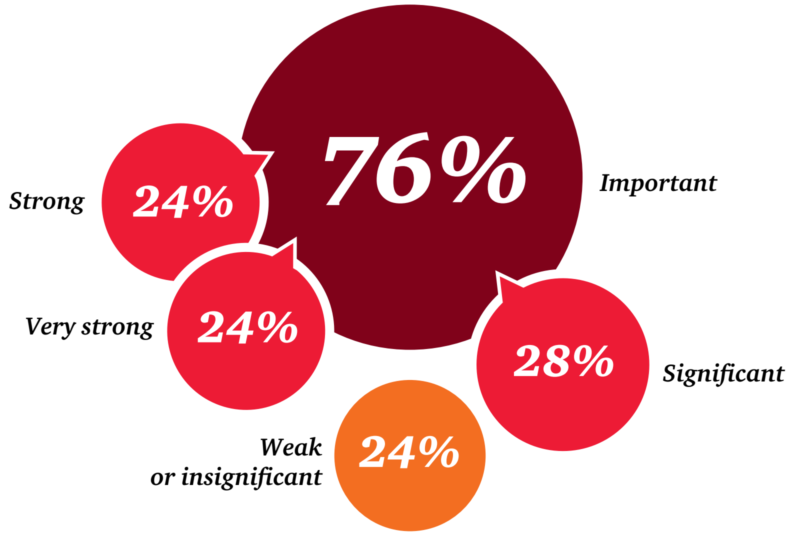
Only 7% of respondents to the survey say that their boards do not respond to megatrends in some way.

How does you board respond to megatrends?



So, what are exactly these five megatrends that cause concerns to the leadership of companies in Russia and worldwide, and how do directors respond to them?

Technological breakthroughs



Did you know?

If Facebook was a country, it would be second most populous in the world (after China)[1].

Around half of US jobs are at risk of being computerized over two decades[2].

There will be seven times more connected devices than people by 2020[3].

[1] Source: PwC analysis of data from Facebook (2014) and UN Population Division, World Population Prospects (2012)

[2] Source: The future of Employment: How Susceptible are Jobs to Computerization?' C. Fray and M. Osborne (2013)

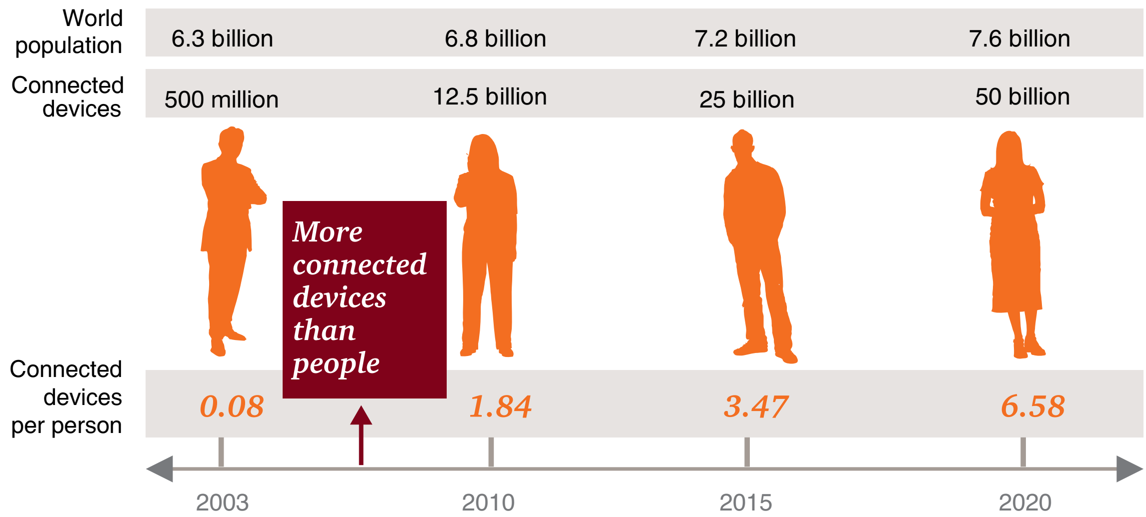
[3] Source: Cisco Internet Business Solutions Group (2011)

According to our survey results, directors believe that, of the five key megatrends identified by PwC, *technological breakthroughs* will have the biggest impact on Russian companies in the long term, with **76%** of directors believing this megatrend is at least important to their companies' business, while **24%** of directors believe that its impact will be very strong.

The impact of *technological breakthroughs* has always been important to the world economy, and has at times been truly transformational. In some ways, for example, the invention of the railway in the 19th century ushered in the modern world. What is clear is that the pace at which such *technological breakthroughs* emerge and become business reality is increasing: if in the early 1900's it normally took decades to implement innovations widely across the world, by the end of the 20th century, it took just a few years, and now it can take mere months, or even days!

Pace of adopting new technologies: first 10 million users in...

The rise of the "Internet of Things"



Source: Cisco Internet Business Solutions Group, April 2011.

Breakthroughs in nanotechnology and other frontiers of research and development (R&D) are increasing production potential and opening up new investment opportunities. Entire new industries are being created which will have a significant impact on the size and shape of the world's manufacturing and high-tech sectors, as well as the companies that operate within them.

The combination of the internet, mobile devices, data analytics and cloud computing will continue to transform our world. For instance, advanced internet technologies enable the exercise of effective control in real-time over the efficiency of business processes, people, equipment, etc., to identify opportunities for enhancing this efficiency and reducing costs. This is particularly relevant in the transportation and logistics sectors of the economy.

Companies' leadership across all sectors should monitor technological breakthroughs and innovations more broadly and question themselves on how these developments will affect (i) consumer expectations; (ii) the way they interact with their customers; and (iii) the underlying business models that support their operations.

Practically, the impact of this megatrend on business is expressed in the fact that companies spend a growing share of revenues on R&D and innovation. A number of industries, besides those which have traditionally been R&D intensive (engineering, armament industry, pharma, etc.), are now in a situation when they have to invest in R&D and innovation. Otherwise, they risk being overtaken by an important industrial change or even squeezed out of business.

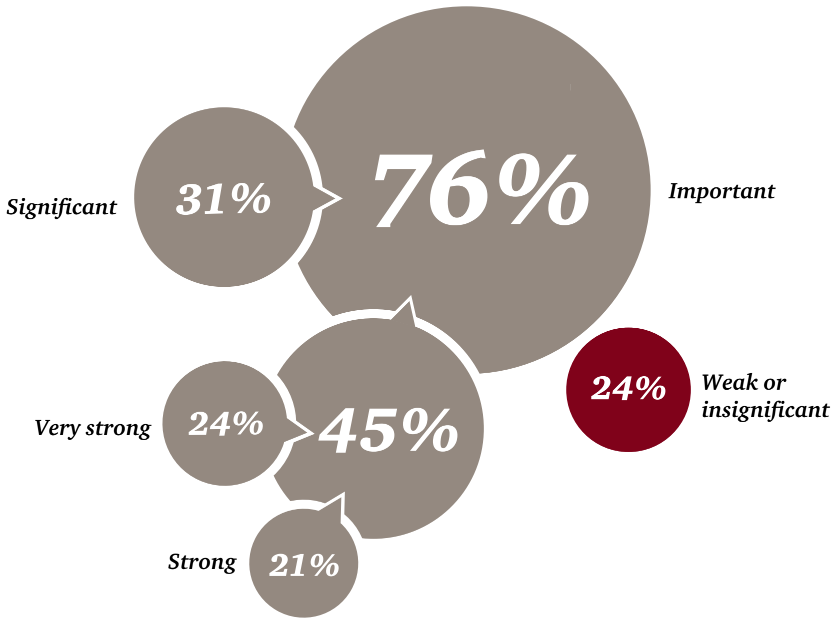
From directors' perspective, it is worth focusing on their companies' investment and innovation strategies and on how they can encourage an innovative enterprise. According to our respondents, **48%** of today's boards actively consider **innovation strategies**. The key is balancing the level of investment in innovation and the risks of investment, such as either having invested and getting no return or not having invested and being passed by.

Taking into account the soaring pace of innovation, in any company's budget there should always be room for expenditures on adopting innovations, even to some extent without prior understanding of what the specific innovations may turn out to be.

According to the survey results, **overseeing of strategic use of technology and related risks**, which was not a major area of focus in previous years, is now a **top priority** for Russian boards, with **72%** of directors wanting more time and focus to be devoted to this issue than in the past.

Today any business cannot determine its long-term plans without taking into account an innovation-driven environment. In order to be competitive, companies should develop and implement a systematic approach to managing innovation activities. Those companies who are not alone on the way, but who seek out the best solutions in terms of synergy and sharing risks will be the most successful. Such solutions may include creating joint ventures and alliances with local and international innovation leaders, investing in innovation-oriented small and medium enterprises (SMEs), co-operating with research institutions, public-private partnerships, etc.

Shift in global economic power



The second most influential megatrend, one selected by **76%** of our respondents as significant, is the *shift in global economic power*.

A realignment of global economic and business activity is transforming BRIC and other growth countries from centers of labour and production to consumption-oriented economies. As they become exporters of capital, talent and innovation, the direction of capital flows is being adjusted.

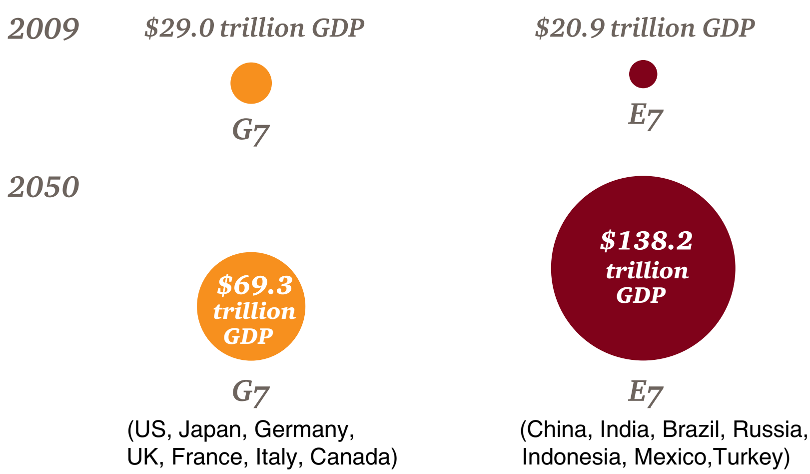
Besides the growth and size of the emerging markets, it's important to appreciate the interconnectivity of the trade and investment flows between them, which are growing much faster than the traditional routes from developed-to-emerging and developed-to-developed countries.

Russian companies have historically been focused predominantly on the Russian and CIS markets. Recently, they have directed their eyes towards rapidly growing economies including Africa, India (especially, in terms of technology), China, Brazil, etc. On the one hand, there's a huge potential for investing in these countries' businesses. On the other hand, these markets, especially China, present excellent opportunities for Russian resource companies since, as they grow, they consume more and more resources. The survey results indicate that the majority of Russian boards (**62%**) consider strategies for **penetrating new markets**. Many Russian companies create joint ventures with local market players as it helps them enter new markets whilst mitigating some risks.

It is also worth thinking about how to best meet demand in particular markets. For instance, rapidly growing economies are still often much poorer than developed ones, which means different needs and purchasing power. In addressing new markets as the global economic power shifts, companies should (i) tailor their products or services to the particular market they are going to enter; and (ii) insure efficient cost management so as to allow them to be competitive with local producers or service providers.

Furthermore, if we take it more broadly, given that globalisation works in both directions, it is also an issue of staying competitive in the home market. According to our respondents, today most Russian boards (**52%**) consider strategies for **diversifying products / services**. Boards need also to look at competitors who are emerging in developing countries with low labour costs and whose cheaper products may provide competition for Russian products in different sectors.

GDP of G7 and E7 countries at US$ PPP



Source: PwC Analysis.

Did you know?

In 2015 the size of the middle class in Asia Pacific is expected to overtake Europe and North America combined[1].

70% of companies could have at least one global business unit head based in Asia before 2020[2].

[1] Source: PwC analysis of OECD projections (2010)

[2] Source: '2013 Asia Business Outlook Survey' (2013)

For companies, penetrating a new market may not only be an issue of direct competitive advantages and of achieving the primary business goal of generating a sustainable financial return for shareholders, it can also be driven by a desire to meet broader expectations by realising side benefits (for instance, facilitating infrastructure development and job creation) and minimising other business side effects (such as negative environmental impact, etc.). In other words, it is also about sustainability and corporate social responsibility (CSR).

A large share of board members (**41%**) say that their boards take measures to address this and other megatrends by considering **sustainability and CSR strategies**. Most directors (**52%**) claim they already give much time and attention to **CSR issues**, while the rest want their boards to devote somewhat more time in the upcoming year to them.

Recently, PwC introduced Total Impact Measurement and Management (TIMM) – an innovative tool which provides a balanced scorecard of a business's social, economic, environmental and tax contribution impact. Such tools help support a business' "licence to operate". The scope of impacts addressed by TIMM include impacts resulting from: (i) direct operations; (ii) downstream distribution, retail and disposal; (iii) upstream suppliers as a result of purchases; (iv) outside the business value chain and the communities a business affects[2].

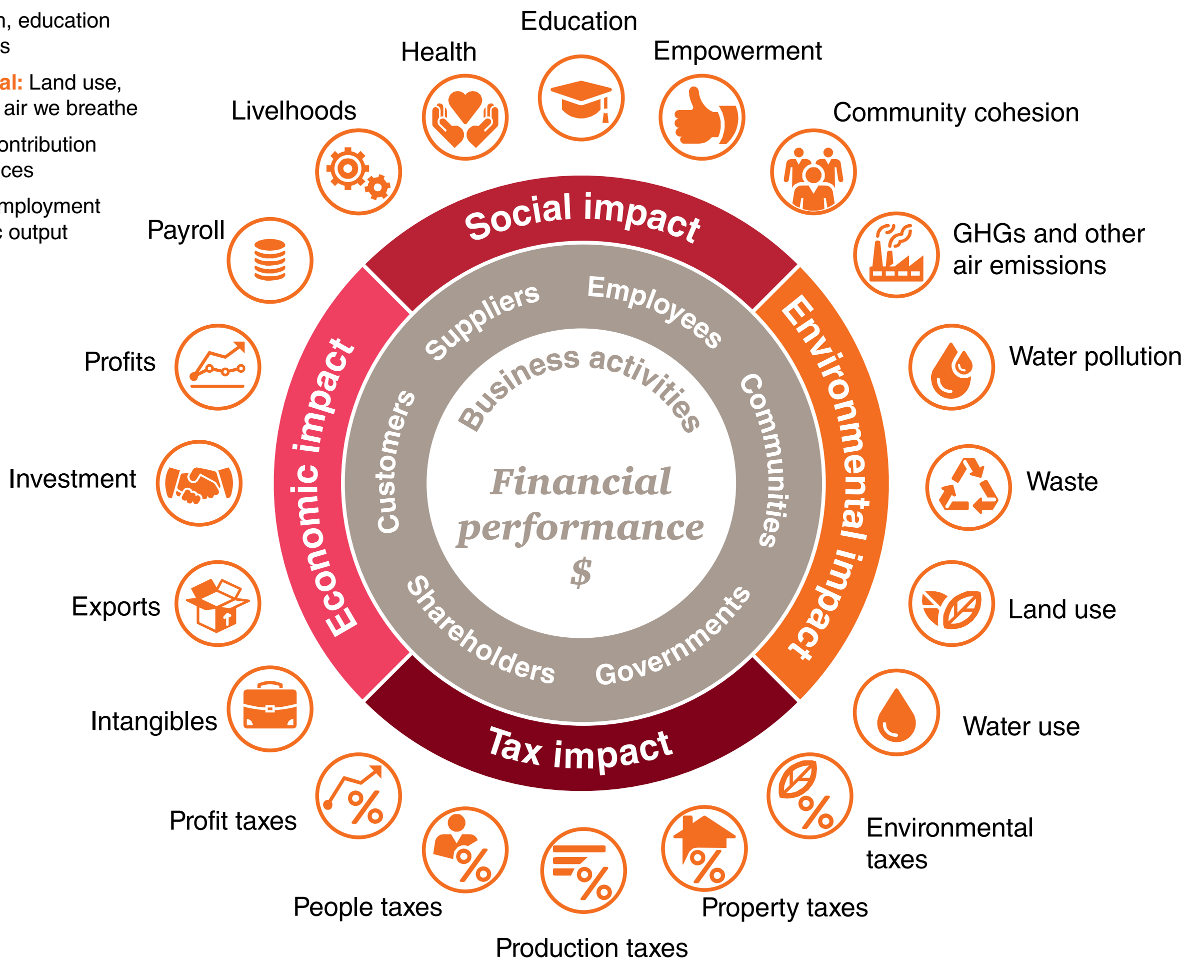
Total Impact Measurement and Management (TIMM): Illustrative dimensions of impact considered

Social: Health, education and livelihoods

Environmental: Land use, water and the air we breathe

Tax: Overall contribution to public finances

Economic: Employment and economic output

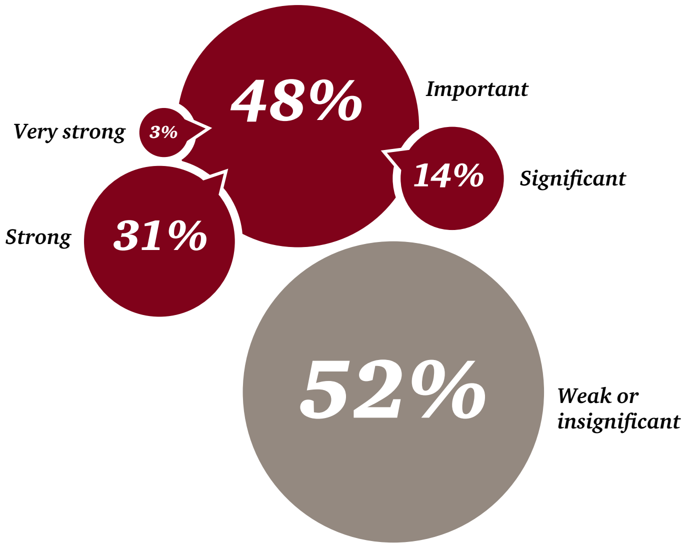


[2] For more information about the Total Impact Measurement and Management (TIMM) see www.pwc.com/totalimpact

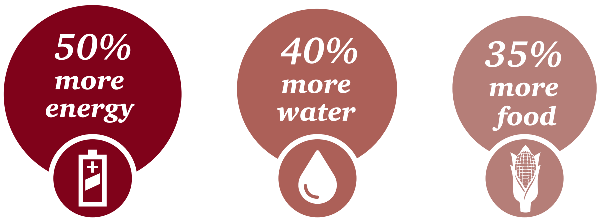
Climate change and resource scarcity

Scarcity of resources and the impact of climate change have been concern No. 1 globally for years. Demand for energy is forecast to increase by as much as 50% by 2030, and water usage by 40%. The potential impact of such growth may include more extreme weather and rising sea levels, which could make traditional methods of farming, hunting and fishing difficult or impossible in some places. The need for sustainable solutions may well be at odds with the need for resources to fuel growth and feed populations. Time-honored traditions will be challenged by changes to the physical environment.

However, in Russia this megatrend does not appear at the top of the list of concerns since board members' views are divided on this issue, with **52%** believing that climate change and resource scarcity are not important to their companies' business. However, a substantial minority (**34%**) believe that this will have a strong or very strong impact on their business. This may reflect the importance of resource based companies in Russia and the still considerable unexploited potential which the country possesses in areas such as water, agriculture and energy. Indeed, whilst posing many challenges, Russia may be a net beneficiary from climate change and resource scarcity.



With a population of 8.3 billion people by 2030, we'll need...

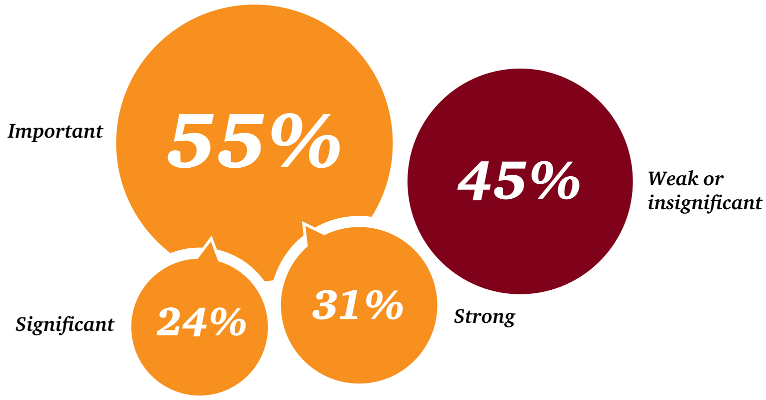


Source: National Intelligence Council: Global Trends 2030: Alternative Worlds.

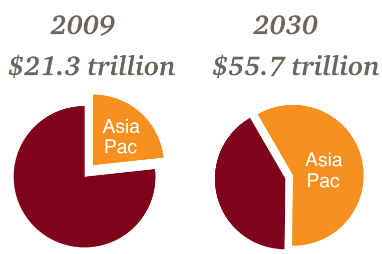
Resource scarcity presents huge opportunities to Russian resource companies and the country's resource-intensive economy as a whole. The reverse of this coin is that this fact does not bode well for the chances that the often expressed desire for the economy to diversify away from dependence on the latter sector will be met, unless a competitive alternative energy source to oil and gas is found. What today's Russian businesses must do in this context is to implement innovative technologies so as to reduce their own energy consumption.

The second aspect of the megatrend is climate change which is associated with much more uncertainty as opinions on this topic are, to coin a phrase, poles apart: some talk about global warming and rising sea levels, others about a new ice age. Regardless of which scenario will turn out to be true, climate change will definitely change the global economic landscape, and will present many challenges, especially for vital sectors such as agriculture.

Even if the extent of humanity's impact on the environment and its correlation with climate change remains unclear, today's businesses are generally expected to demonstrate environmental friendliness and more socially responsible behavior. Consequently, we return to the sustainability and corporate social responsibility issues mentioned above. Indeed, this angle is relevant to all five megatrends.



Spending of the global middle class, in 2005 US$ PPP



Source: Data taken from OECD Development Centre Working Paper number 285, "The Emerging Middle Class in Developing Countries," January 2010.

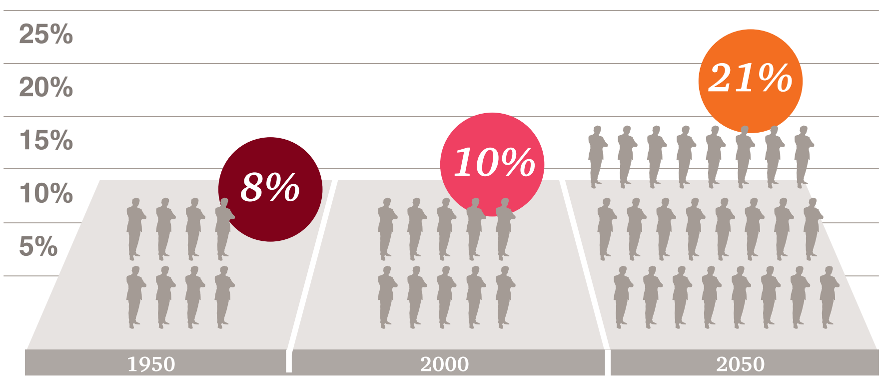
Demographical shifts

Overall, **55%** of our respondents believe that *demographical shifts* are likely to have a material impact on their companies in the long term, with **31%** of directors evaluating this impact as strong.

Countries around the world have very different demographic trajectories. Some societies are aging rapidly and their workforces will be constrained as a share of the total population. Other societies are young and growing, which will create ever larger potential labour forces and consumer markets, but still pose social and economic challenges.

Explosive population growth in some areas against declines in others contributes to everything from shifts in economic power to resource scarcity to the changes in societal norms. Respectively, businesses can respond to these in different manners from penetrating new markets to implementing CSR strategies.

Proportion of the world population aged 60 years or more



Source: UN report World Population Ageing 1950–2050.

Russia has a specific demographic challenge. The country went through a major demographic crisis in the early 1990s when it experienced a real baby bust (a generation gap). As over two decades have passed, now the time of "baby busters" or "children of perestroika" is coming, which means we are about to face a potential shortage of graduates, young qualified personnel and workforce generally in Russia, which will naturally be followed by increasing competition and higher costs of labour. In the pursuit of cheaper workforces businesses may resort to hiring citizens of poorer regions or countries thereby boosting mass migrations, which brings us to another megatrend – *accelerating urbanisation*.

Did you know?

50% of the world's population growth between now and 2050 is expected from Africa[1].

In 2020, for the first time, the majority of births in both North America and Europe will be to a mother aged over 30[2].

400 schools are shut down in Japan each year due to its ageing[3].

[1] Source: UN Population Division, World Population Prospects (2012)

[2] Source: UN Population Division, World Population Prospects (2012)

[3] Source: FT (2014)

But before proceeding to accelerating urbanisation, we should touch upon another feature of today's demographic context – Generation Y.

This term refers to people born roughly between 1988-1999, and Generation Y are generally seen as ambitious, with high demands and expectations, and importantly, with a quite different business approach and motivation from earlier generations. Research suggests that the primary motivation factors for Generation Y are (i) learning and development at work; (ii) work-life balance; (iii) mobility; and (iv) choice management.

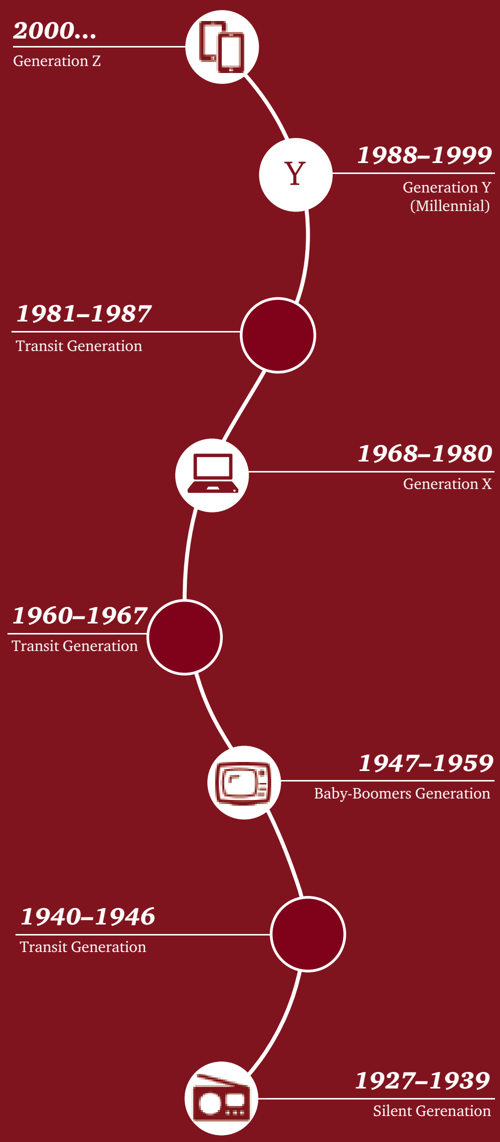
The combination of demographic shifts and the Generation Y phenomena mean that companies all over the world are already grappling with the need to manage generational diversity by creating effective motivation systems and working conditions attractive for a new generation of employees.

It is worth noting that while US and European boards are extensively involved in human capital issues, Russian boards' engagement in the topic has normally been limited to considering executive compensation issues. Boardroom best practice implies holding annual meetings dedicated to human capital issues – hopefully, this practice will be replicated in Russian companies in the nearest future. Indeed, **developing human capital** is high on the list of priorities for Russian boards this year, with **73%** of directors wishing more time and focus to be devoted to this matter in the boardroom.

To look at the issue more broadly, a board's role is to oversee strategic workforce planning, which assumes assessing (i) the demand for the workforce in the long-term (headcount); and (ii) the supply of the workforce and the recruitment efforts to be applied (including assessing the turnover, retirement age, motivation factors, etc.). The objective is to identify any strategic gaps between the demand and supply of specific types of talent in your workforce and to find the best ways of addressing such gaps via strategic targeted hiring, developing human capital and ensuring succession planning[3].

Turning to Generation Y, another issue here is that its representatives are already entering the market place as young brand new entrepreneurs, business people and managers. Their key distinguishing features are an entrepreneurial spirit and heightened risk appetite, as well as mobility. Obviously, a new management style may completely change existing business models and practices – this is also something worth getting prepared for. Does your board relate to the new generation? Among the Top 3 priority board matters in the upcoming year directors point to **executive succession planning**: the number of directors wishing more time and focus to be devoted to this issue in the boardroom has now reached **83%** (versus 70% in 2013 and only 35% in 2012). That said, it is probably worth thinking about Generation Y managers today in terms of adding a different perspective on a business' direction. Ultimately, this is the generation who will be needed to face the challenges that the fast-paced world is going to present.

Change of generations



[3] To find out more about strategic workforce planning and specifically about Strategic People Planning (SPP), a tool introduced by PwC, see www.pwc.com

Accelerating urbanisation

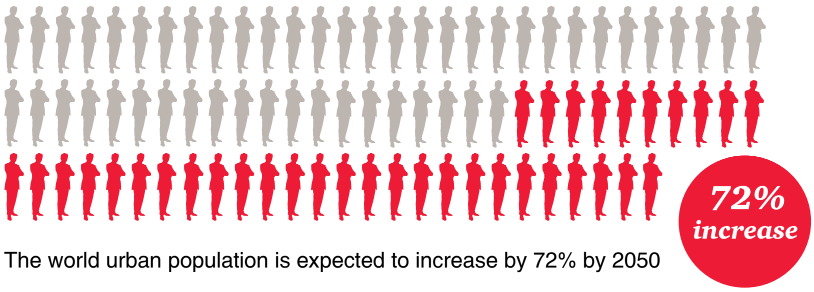
In the 1950s, less than 30% of the world's population lived in cities. Currently, that proportion has risen to 50% and, by 2030, the UN projects that some 4.9 billion people will be urban dwellers. By 2015, the UN estimates that there will be 22 mega-cities – those with populations of 10 million or more – with 17 located in developing economies. By 2050, it is estimated that the world's urban population will have increased by some 72%. Much of the growth in urban population will likely take place in Asia and Africa.

Large scale migrations from rural areas will power much of this growth. In developed economies and older cities in the developing world, infrastructure will be strained to the utmost, and beyond, as populations expand. At the same time, in emerging economies, new cities will rise rapidly and require massive investments in smart infrastructure to accommodate explosive growth.

Against this context, it is perhaps just surprising that only slightly more than a **half** of Russian respondents to our survey take *accelerating urbanisation* seriously as an issue and believe it will have significant implications on their companies. Only **17%** of respondents believe that the possible implications of accelerating urbanisation today deserve more directors' time and focus than in the past.

Yet, there is much to think about. While presenting huge opportunities for infrastructure companies, accelerating urbanisation could also imply higher office rental costs, on the one hand, and a decreasing standard of living and working in urban areas, on the other (this includes traffic jams, higher product and service prices, much more expensive residential property, etc.). Fortunately, there are instruments available for companies to approach such challenges.

World urban population



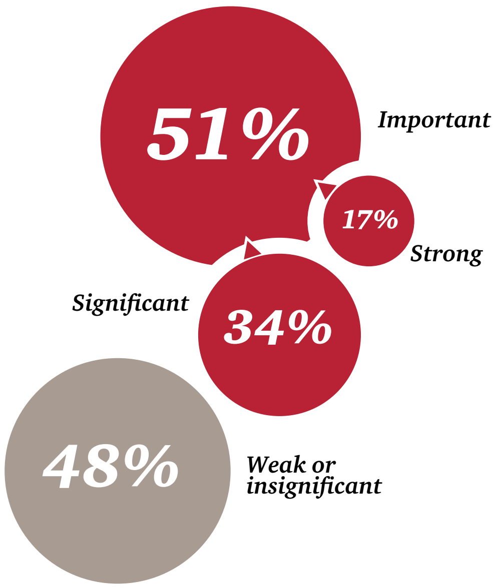
The world urban population is expected to increase by 72% by 2050

Source: World Urbanization Prospects: 2011 Revision, Produced by the UN Department of Economic and Social Affairs.

Advanced technologies may allow companies to adopt a "working from anywhere" model, which definitely helps to save on office rental. However, along with presenting possible benefits, this model does raise possible difficulties in regards to motivating people to work effectively with minimum or no supervision and heightened risks of IT security, which also need to be addressed.

Alternatively, companies can resort to outsourcing. Another quite popular instrument is creating shared service centres in regions with cheaper premises and workforces (this is particularly relevant for accounting and finance services, IT, etc.).

If your board is not thinking about the impact of greater urbanisation, perhaps your competitors are. Should this worry you?



Did you know?

60,000 people added to the Chinese and Indian urban population every day[1].

1,5 million people are added to the global urban population every week[2].

By 2025, there could be nearly 40 cities with a population of over 10 million[3].

[1] Source: PwC Cities of Opportunity (2012)

[2] Source: United Nations, Department of Economic and Social Affairs, Population Division (2012)

[3] Source: LIN Department of Economic and Social Affairs (2012)

Most Russian boards take megatrends into account when determining the company's strategy

Issues in focus

In addition to our focus on megatrends in 2014, we have also updated our data on more familiar topics concerning boards.

In each of the PwC board surveys over the last three years, we have asked our respondents to name issues that they would like their boards to focus on during the next year. This data shows some interesting trends.

Strategic planning has been on top of the priority list for two years already: **90%** of respondents say they would like their boards to give this issue more attention (versus 87% in 2013 and 52% in 2012), with **45%** also believing this issue requires much more time and focus.

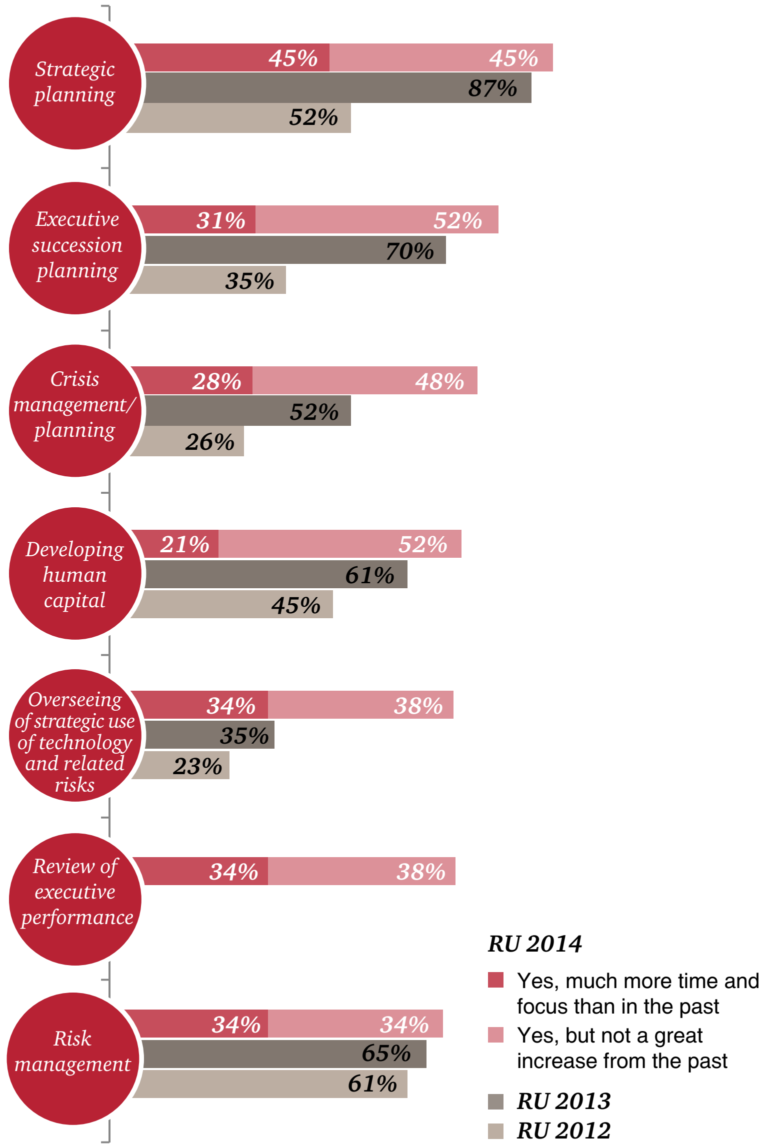
With market conditions still tough in Russia, and new challenges emerging, getting the right strategy remains crucial to a company's chances of success. According to our respondents, **69% of companies already take megatrends and their possible implications into account when determining company strategy**.

Looking forward, **86%** and **69%** of directors want their boards to devote more time in the coming year to *technological breakthroughs* and *shift in global economic power* respectively when determining company strategy.

In addition, **45%** and **41%** of board members believe they should devote more time and focus to *demographical shifts and climate change* and *resource scarcity*, respectively.

Seven hot topics in 2012–2014 in Russia

Figures refer to the percentages of respondents believing their boards should devote more time and focus to a particular issue

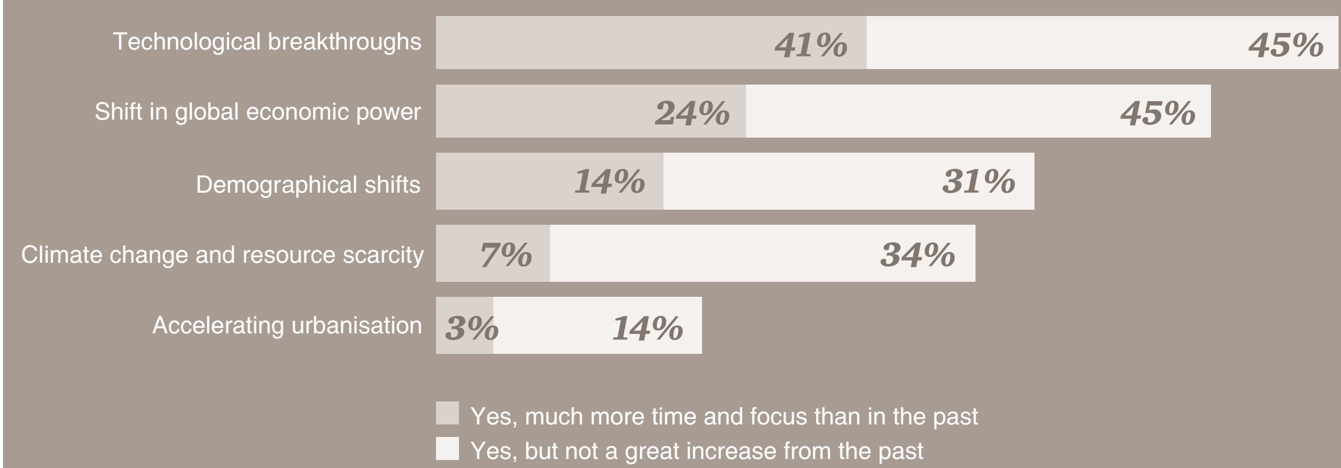


In 2014, **overseeing strategic use of technology and related risks has moved up** to share second place as an issue: the number of directors believing that their boards should dedicate more time and focus to this issue has almost doubled since 2013 to reach **72%**. Boards' scrutiny of this topic is not surprising, given that most directors recognise the probable effects of technological breakthroughs as a megatrend in the long term.

Review of executive performance is also a priority this year: the number of directors wishing more time and focus to be devoted to this issue in the boardroom is **72%**.

Other issues which are also high on the list of priorities this year are risk management and crisis management/planning (taking into account a wide range of emerging risks incurred by megatrends), executive succession planning and developing human capital (hereby addressing, inter alia, such megatrends as demographical shifts and accelerating urbanisation).

Please indicate if you would like your board to devote more time in the upcoming year to considering the following megatrends and their possible implications when determining the company's strategy:



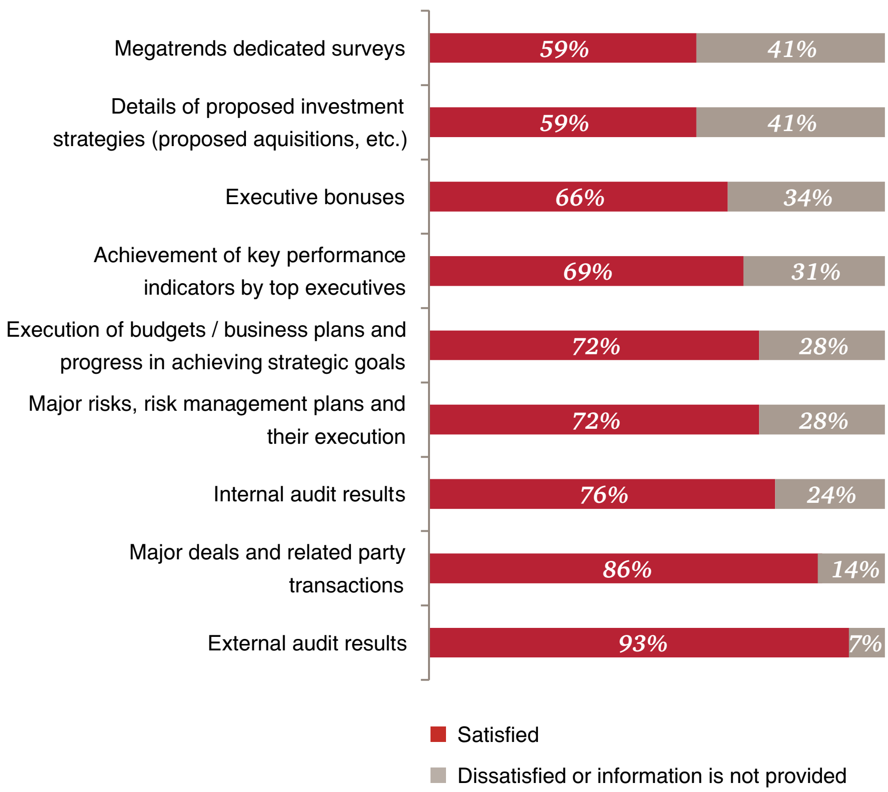
Forewarned – forearmed

Getting sufficient information and information of the right quality on a timely basis is a key to efficient decision-making.

We asked our respondents about their level of satisfaction with the information provided to their respective boards. Just like a year ago, directors expressed their satisfaction with the provision to their boards of information concerning **external audit results** (**93%** of satisfied directors in 2014 and **95%** in 2013) and **major deals and related party transactions** (**86%** in 2014 and **91%** in 2013).

However, there is clearly room for improvement in some areas. For instance, **41%** of directors are dissatisfied with the provision of **surveys focused on megatrends and details of proposed investment strategies** to their boards. This again points to the fact that directors want a deeper understanding of business prospects and strategies in the global context, because being better informed means being better prepared. Finding sustainable approaches to business development means attempting to understand megatrends and putting in place systems to monitor changing conditions and related risks, as well as seeking the best ways to address these issues.

How satisfied are your with the following information provided to your board?



Another finding is that **boards want more control over executive performance and bonuses – 34%** and **31%** of directors are dissatisfied with the provision of information about **executive bonuses** and **achievement of KPIs by top executives**, respectively. A potential area for improvement lies with the provision of information on **execution of budgets / business plans and progress in achieving strategic goals**, with **28%** of directors stating they are dissatisfied with this.

Outlook on boardroom activities

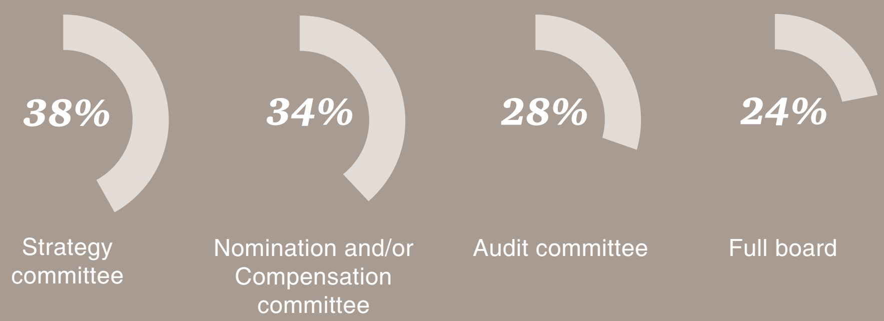
Time commitment is on rise

This year many directors have continued to increase their time commitment for boardroom activities, and especially with regard to participation in **strategy committees** (an increase is reported by **38%** of directors) and **nomination and / or compensation committees** (**34%** of directors), as well as activities that address such key topics as strategic planning, executive performance review and executive compensation.

Somewhat fewer directors reported an increase in their time commitment for audit committee activities (**28%**).

Increase in directors' time commitment over the last 12 months

(Figures refer to the percentages of respondents claimimg their time commitment to the following has increased over the last 12 months)



69%

The meetings make effective and efficient use of director's time

24%

The meetings would be better if we spent less time on presentations by management

21%

The meetings would be better if we spent less time on administrative matter

17%

The meetings would be better if we spent less time on compliance matters

Less of formality – more of an open discussion

Although directors' commitment for board and committee activities has been consistently increasing over recent years, many directors are critical about the efficiency of the time spent. One alarming statistic is that only **69%** of directors believe that **board and committee meetings make effective use of their time**.

Directors want board meetings to be less about administration and formalities and more about substance and open discussion of key business issues. Quite a few directors believe they spend an excessive amount of time on administrative matters (**21%**), compliance matters (**17%**) and management presentations in the boardroom (**24%**).

Directors appear to believe their time could be better spent on open discussions and collective thinking – particularly in focusing on issues such as megatrends, strategy and risks.

According to the recently approved Corporate Governance Code in Russia, "discussion of matters and recommendations thereon provided by committees of the board of directors, as well as passing respective resolutions, should take a considerable part of time at a board meeting"[4]. Directors clearly agree!

It's good to talk

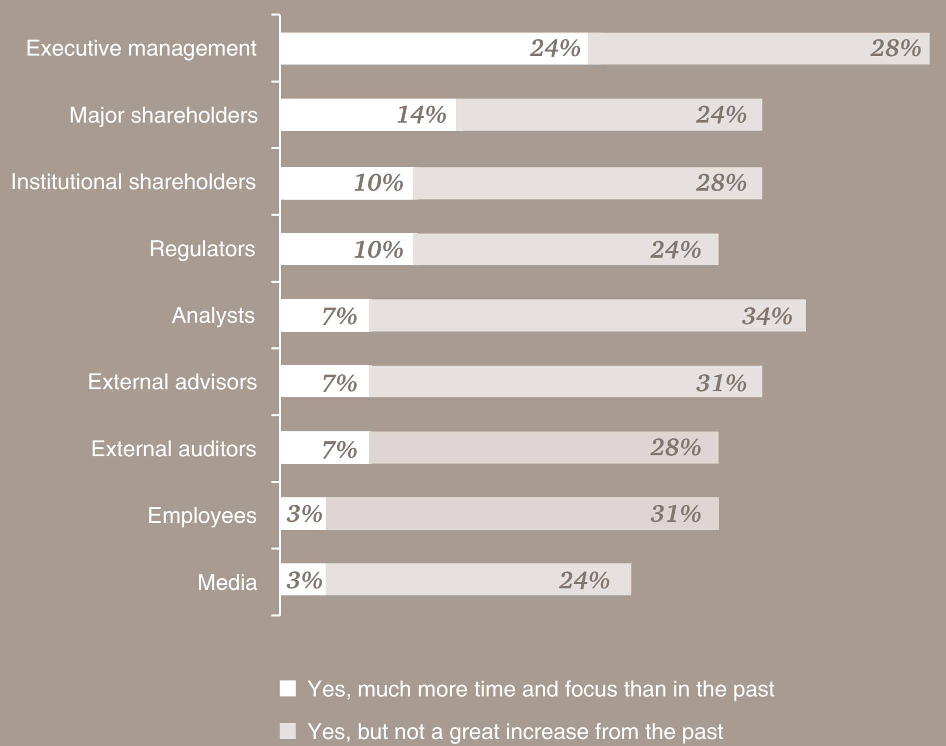
The results of our surveys indicated that Russian boards are getting increasingly involved in communications with various stakeholder groups.

Still, many directors expressed their willingness to devote even more time **to communication with executive management (52%), major and institutional shareholders** (**38%** for each), analysts (**41%**), regulators (**34%**), etc.

[4] New Corporate Governance Code was approved by the Board of Directors of the Central Bank of Russia (CBR) on 21 March 2014.

These trends probably reflect the fact that, in a world of uncertainty, one never knows where threats are going to come from. In this context, constantly seeking the opinions of different stakeholders helps keep a sharp look-out. Ultimately, leaders who do not understand and listen to their stakeholders and who lack the willingness and ability to change will be passed by, as their markets and customers move on without them.

Please indicate if you would like your board to devote more time in the upcoming year to communication with the following groups of stakeholders?



Board evaluation

From form to substance

Whilst boards in Russia are increasingly often examining ways of improving their effectiveness, Russia still lags behind the world in this best practice.

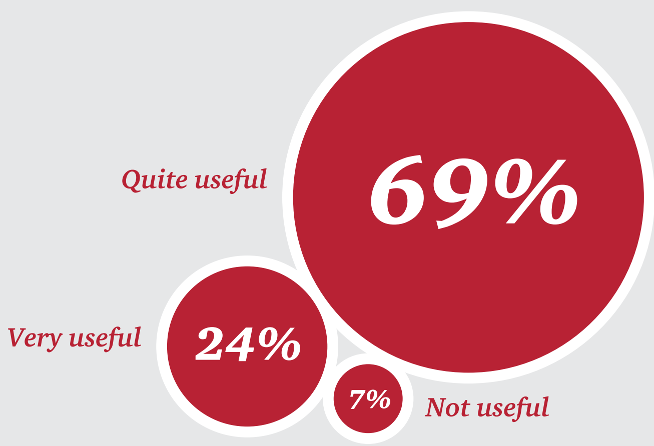
According to our respondents, **62%** of boards **carry out performance evaluations on a regular basis** compared to **87%** in the UK.

Over **93%** of the directors surveyed **consider board evaluations to be useful**, or, if this practice has not been introduced in their companies yet, potentially useful.

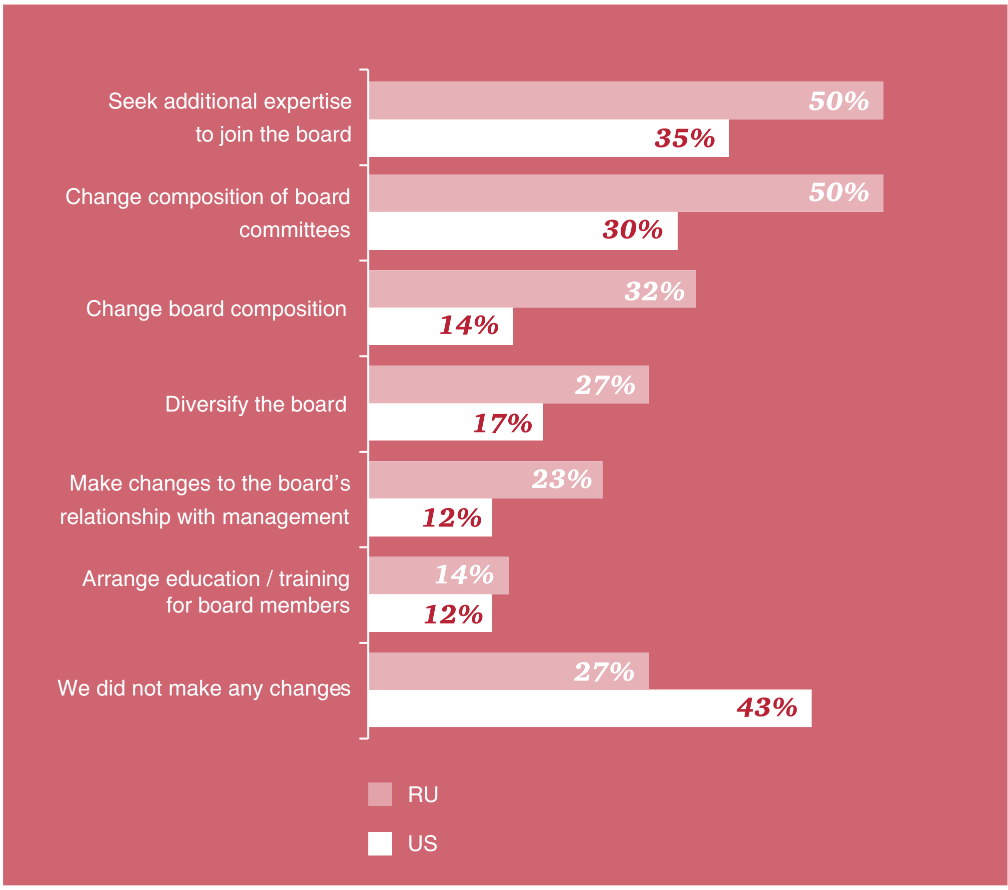
The effectiveness of board evaluations and the benefit they provide depend on the quality of the process and the enthusiasm with which they are approached. To get the most out of board evaluations an outside view of a board's effectiveness is essential. Indeed, external facilitation of board evaluations adds objectivity and value to the process.

Does your board carry out regular evaluations of board performance?

In your opinion, how useful are board evaluations (or, in case of having no board evaluations, how useful they could potentially be)?



In response to issues identified during your last board evaluation process, did your board decide to do any of the following?



Until now, many companies have not been open to external evaluations, preferring to undertake an internal process instead. In the prevailing number of cases, board evaluations in Russian companies are performed in a form of **self-evaluation** (**59%**) while only **38%** of boards **combine self-evaluation with externally facilitated evaluation**. However, we anticipate that over the next few years, more companies will conduct external evaluations to comply with the new Corporate Governance Code.

Following up on board evaluation results

It is essential that board evaluation be considered as a development tool rather than a compliance formality. The idea is to better understand how the functions and dynamics of a board and individual directors can be enhanced.

Our survey results indicate that board evaluation is an effective tool for identifying areas for improvement in terms of the composition of boards and committees. Half of the directors say that in response to board evaluation results they decided to **look for additional expertise** to join the board.

A similar number of directors said that their boards responded by **changes to the composition of board committees**, and in **32%** of cases, it was decided to **change the composition of the board** itself. In particular, **27%** of companies addressed the issue of boosting board effectiveness by **diversifying the board**.

"Specifically, we find that for large-cap stocks (market cap greater than USD 10 billion), the companies with women board members outperformed those without women board members by 26% over the past six years. For small-to-mid cap stocks, the basket of stocks with women on the board outperformed those without by 17% over the same period."

Gender diversity and corporate performance, Credit Suisse Research Institute (2012)

72%

of Russian boards and

59%

of US boards believe that companies should arrange education / training for board members.

Top 4

desired skills in Russia and US:

- *Industry expertise*
- *Risk management expertise*
- *Financial expertise*
- *International expertise*

Back to school?

Despite the fact that not many Russian boards arrange education / training for board members, **72%** of our respondents in Russia believe such education is important. For instance, **59%** of respondents in the 2013 US survey advocated that all directors be required to attend board education / training on an annual basis.

Lacking know how?

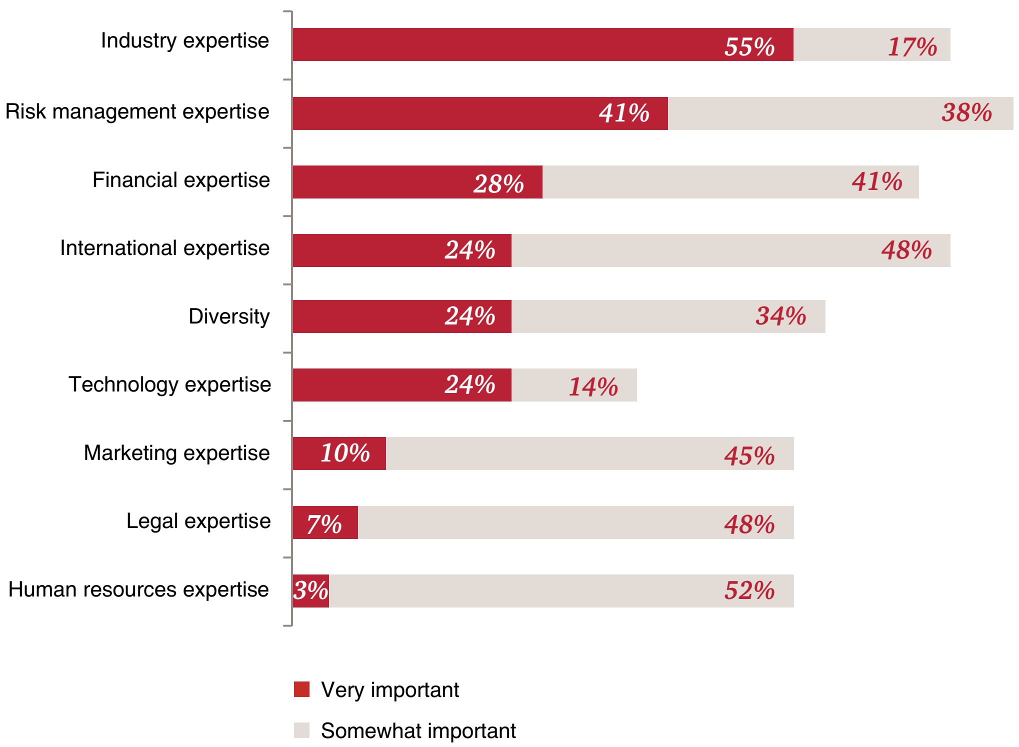
The results of our annual surveys indicate that most Russian boards still lack directors with particular expertise and qualities.

Industry expertise is the most wanted in both Russian boards and US boards. Other much desired skills and attributes include risk management expertise, financial expertise, and international expertise.

While industry expertise and financial expertise are something that a board needs at all times, international expertise and risk management expertise are becoming particularly important in the context of a rapidly changing global economy in order to address megatrends and the additional risks that today's boards are facing.

Diversity is another increasingly popular topic among Russian boards this year, with **24%** of directors believing that enhancing the diversity of their boards is very important.

How would you currently describe the importance of adding directors with the following skills / attributes to your board?



45%
of Russian boards believe that someone on their board should be replaced

Are your colleagues fit for purpose?

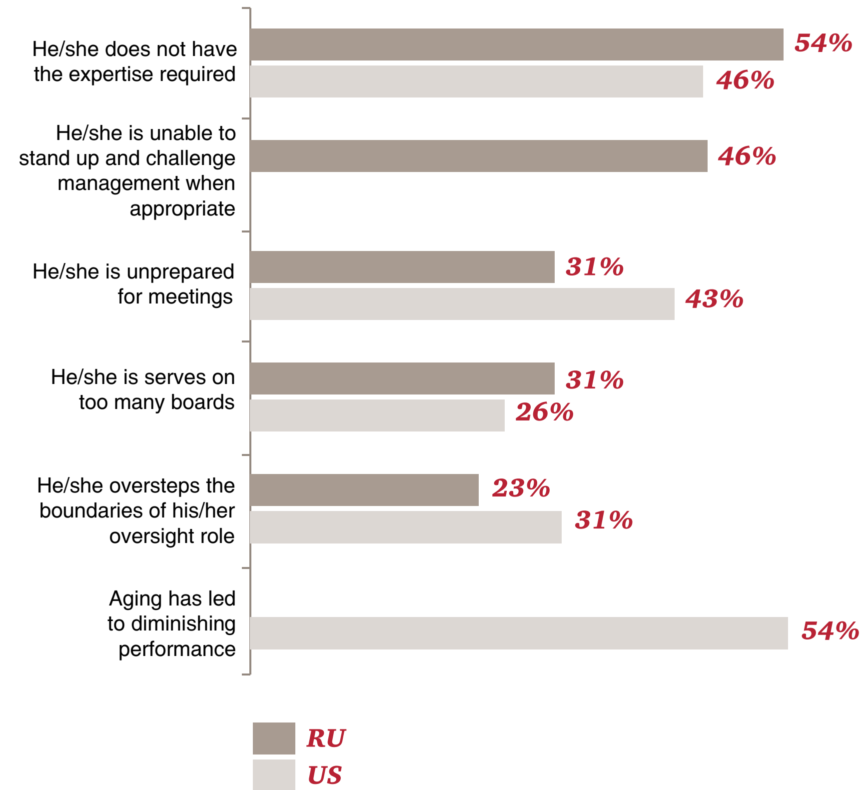
Lack of expertise is the top reason why directors are critical of their fellow board members.

Director nomination, election and dismissal are out of boards' purview, as this matter is reserved for shareholders. Nonetheless, boards and their nominating committees can practically influence the decision-making process by giving their respective recommendations to shareholders.

For example, **45%** of directors in Russia believe that some of their fellow board members should be replaced (versus **35%** in the US), with a **lack of required expertise** and a perceived **inability to challenge management** being the major reasons for expressing this view – **54%** and **46%** of the directors believing there should be changes on their boards cited these specific reasons, respectively.

Interestingly, diminishing performance due to aging, which is the top reason in the US, as cited by **54%** of respondents, is not a concern for Russian boards at all.

Do you believe that any of your board members should be replaced for the following reasons?



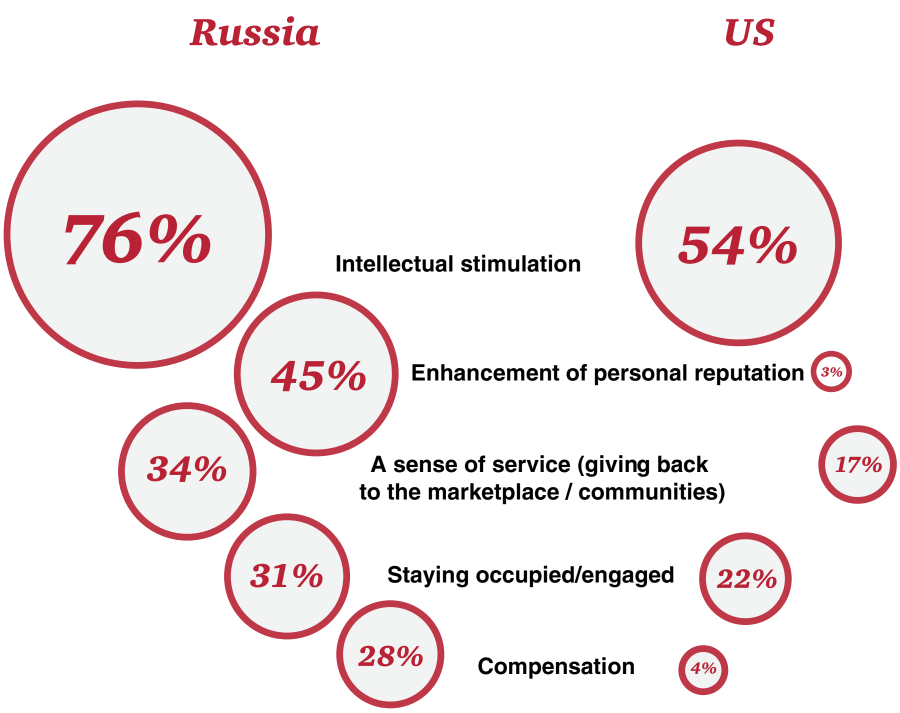
What are the impediments to replacing an underperforming director?

	Board leadership is uncomfortable addressing the issue	Not having individual director assessments	Board assessment processes are not effective	Major shareholder ignores the issue	No real perceived impediments
Russia	41%	38%	31%	24%	0%
US	20%	11%	8%	0%	35%

In practice, replacing underperforming board member can be difficult. Indeed, **all** of our respondents in Russia and **65%** of respondents in the US say there are certain impediments to doing this. Members of Russian and US boards point to the importance of strong board leadership in dealing with this challenge. They say the top constraint is that **board leadership is uncomfortable with addressing this issue**. This inhibitor was cited by 41% of our respondents in Russia.

The **second and third most frequent explanations** for failure to deal with underperforming directors are a lack of individual director assessments and ineffective assessment processes. Finally, nearly **one quarter** of Russian board members say the problem is that major shareholders may ignore the issue, perhaps reflecting more concentrated shareholder structures and the role of the state in Russia.

What is your primary motivation for sitting on a public company board?



Director motivation – is it just about money?

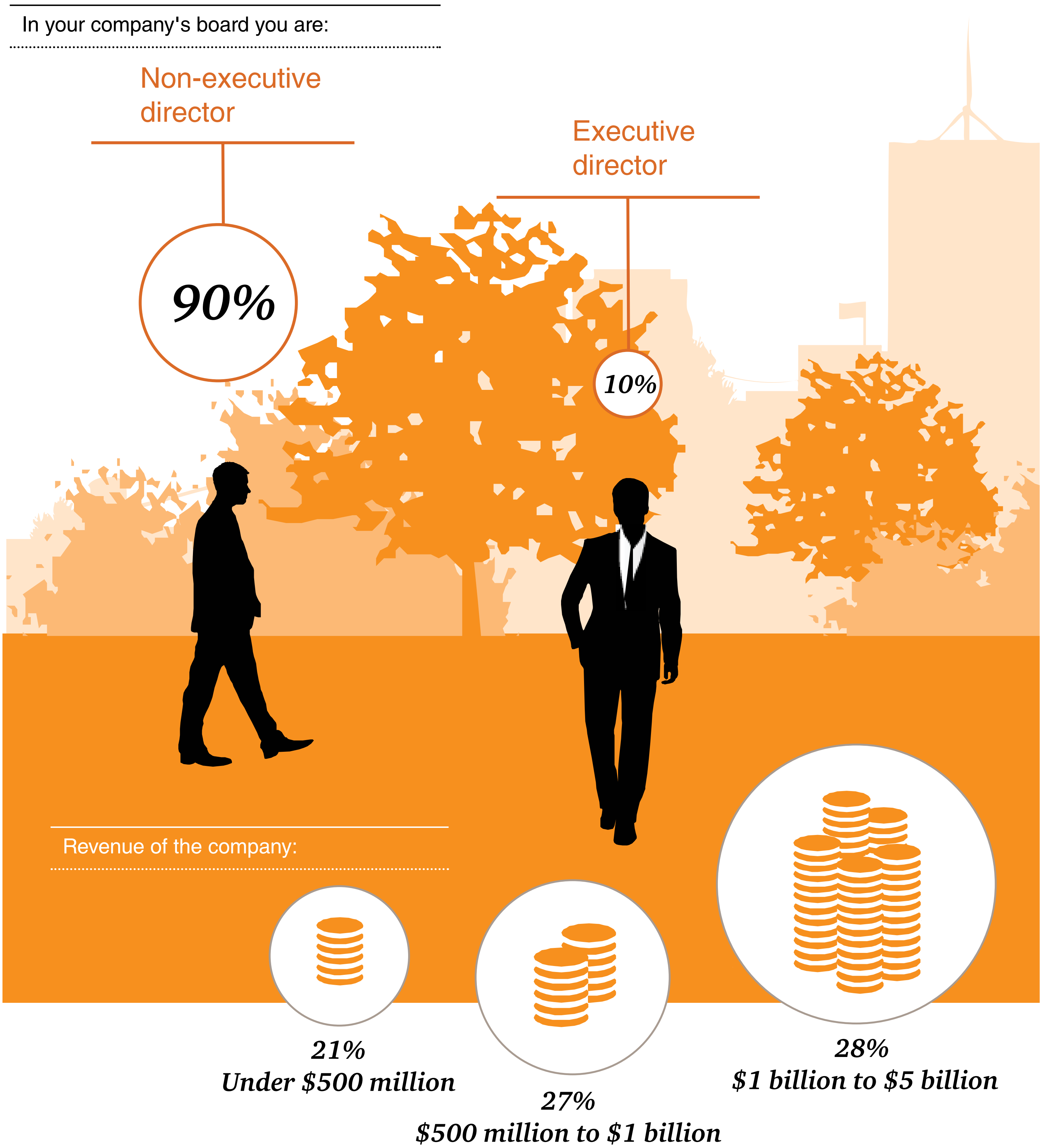
Our respondents were asked to explain what motivates them to be board members. One thing is for sure: it's not always about money (compensation ranks last in the list of motivation factors with only **28%**).

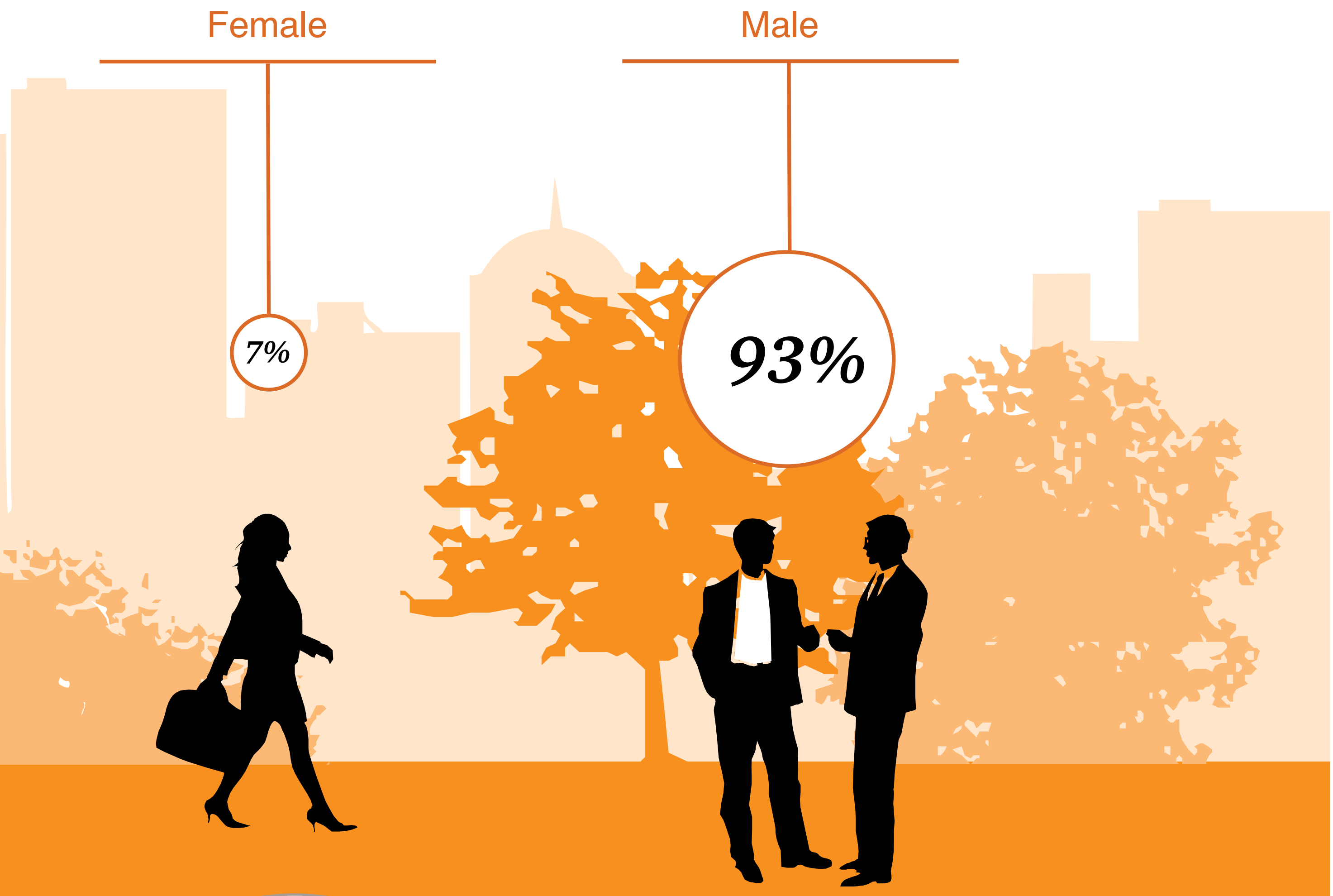
According to the directors surveyed, the primary motivating factor for sitting on a board is evidently intellectual stimulation (chosen by **76%** of respondents in Russia and **54%** in the US). Thus, the vast majority of directors are seeking an interesting and dynamic environment. This is good news as the megatrends highlighted in this report mean sitting on a board is going to be both fun and challenging!

Quite a few directors in Russia and the US indicate they want to give something back, and many see board service as a way of being engaged with the market or community.

Remarkably, for **45%** of our respondents in Russia, board membership is a means of enhancing their personal reputation, while only **3%** of US board members cite this reason.

About the respondents





The participants in the 2014 PwC Russian boards survey are members of the boards of directors of **73** Russian companies with different activities and shareholding structures, **nearly a half of which generate annual revenues of over USD 1 billion each**. In addition, 90% of our respondents represent public companies, most of which are listed in Russian and/or abroad while 24% represent state-controlled companies. Furthermore, **90%** of the directors are non-executive directors, with most being independent (**72%**).

24%
Over $5 billion

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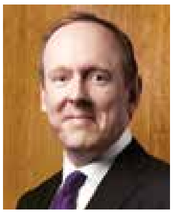

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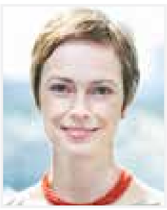

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