THE CORPORATE BOARD

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Challenges To Compensation Committees In 2021

by Terry Adamson and Judy Canavan

Over the past year, corporate executive pay setting has gone from being difficult to excruciating. The COVID-19 crisis, stakeholder concerns, and pay equity pressures now force compensation committees to juggle uncertain, fast-changing, and often contradictory demands.

The global pandemic and social unrest of 2020 presented many challenges to businesses around the world. For 2021, boards of directors continue to grapple with the human and economic toll caused by COVID-19. Within this environment, they are compelled to weigh a broader range of corporate stakeholders. As such, boards must consider how these forces have changed their roles, what new expectations there may be, how best they can meet them, and what the implications are for company performance and executive pay.

To understand the board compensation committee's job in 2021, we examine three shifts that were underway in 2019 and early 2020—greater consideration of critical stakeholders; ensuring pay equity; and the setting of rigorous performance goals (and how the pandemic accelerated or altered them).

☐ ***Shift No. 1: Elevation of critical stakeholders.*** Traditionally, the primary stakeholder has been thought of as investors. However, before the pandemic, this definition was already starting to broaden. In August 2019, the Business Roundtable released a statement signed by 181 CEOs saying the purpose of a corporation is to promote an economy that serves *all* Americans.This expands the previous focus from shareholder primacy to specify additional stakeholders such as employees, suppliers, customers and the community. Though some considered it somewhat controversial, committees are now focused on thinking about how executive pay should be structured to address the impact of these additional stakeholders.

Underscoring the recognition of human capital as one of a company's primary drivers of stock price and company value was the SEC's Regulation S-K amendment in 2020. It requires companies to disclose information about their human capital resources, including measures or objectives that they use to manage their businesses. Compensation committees are likely to embrace this human capital strategy, including employee engagement, talent development, succession planning and oversight of diversity and inclusion efforts.

Linking executive pay to the performance of stakeholders as well as other aspects of environmental, social and governance (ESG) criteria poses challenges. Based on our analysis of the BDO 600 companies, about 14 percent mention specific ESG metrics used in their short-term incentive plans. To move the needle, the committee will need to fully understand the value drivers of the company, which metrics should be used to gauge progress, and the extent to which goals achieved can and should be reflected in executive pay.

As businesses face another wave of the pandemic, the incorporation of ESG measures into pay plans will likely take a back seat to other metrics.

Institutional investors' growing focus on ESG is reverberating through incentive discussions as companies evaluate the use of ESG goals or metrics in their 2021 annual bonus and performance share unit plans. Ultimately, though, use of ESG metrics needs to be guided by their linkage to company performance.

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As businesses contend with another wave of the pandemic, the incorporation of ESG measures into pay plans will likely take a back seat to other metrics, specifically those relating most directly and immediately to company performance. For companies that do use ESG metrics, they will likely represent a nominal portion of incentives. This is because there is limited ability to track the impact of many ESG measures on company success and inadequate objective scoring with ESG measures.

With the expanded definition of stakeholders, compensation committees have to consider where they will focus their attention. Boards need to question whether having additional stakeholders will "dilute" or shift the focus away from investors, or whether investors will trump the other stakeholders and thus dilute the focus on them.

From a public company perspective, the overarching strategic objective is to create shareholder value. With the increasing awareness of the importance of other stakeholders, boards face the challenge of determining the role of these stakeholders in creating shareholder value, and how to best manage and cultivate this value.

When COVID-19 hit, many employees had their pay reduced as companies sought to save cash to navigate the effects of the pandemic recession.

☐ ***Shift No. 2: Pay equity.*** Another compensation shift underway at the end of 2019 was pay equity. Before the pandemic, there was increased focus on gender and minority pay equity. When the pandemic hit, many employees had their pay reduced as companies sought to save cash to navigate the effects of the pandemic recession.

As of December 2020, women had lost the most jobs since February, 5.3 million versus 4.6 million for men, according to the U.S. Bureau of Labor Statistics. While many of these jobs reside in service-oriented industries, the pandemic's disproportionate impact on women and minorities may result in increased cultural and societal pressures for pay equity in general.

BDO's study on CEO/CFO pay found that 14 percent of board members, 19 percent of CEOs, 17 percent of CFOs and 17 percent of NEOs (named executive officers) took a pay cut, in part to show solidarity with their employees. However, these reductions were temporary, generally lasting about six months. As some employees have struggled, committees will need to ensure that executives are not benefiting financially as a result of employee layoffs or pay reductions.

Compensation committees also need to be mindful of the possibility that executives are being overpaid relative to performance. Many have seen their pay rise with the value of the stock that comprises a significant portion of their compensation.

According to the BDO 600 report, equity and other long-term incentives comprise over 55 percent of the CEO's compensation package. This means stock price performance has a very significant impact on the level of executive pay, and could risk equity plans overriding the performance impact of other incentive plans.

Boards also need to watch for employee pay reductions that result in generating better profits for the company. Better profits may, in turn, result in funding an executive bonus.

COVID-19 increased scrutiny of "excess pay" by proxy advisory firms, amplified existing compensation issues and created urgency for change. The CEO pay ratio for companies in the S&P 500 was up to 264:1 in 2019, and companies should be mindful that any year-over-year increases to the CEO pay ratio will be closely scrutinized.

In March, 2020, Glass-Lewis observed "Trying to make executives whole at even further expense to shareholders and other employees is a certainty for proposals to be rejected and boards to get thrown out—and an open invitation for activists and lawsuits onto a company's back for years to come." As the pandemic continues into 2021, boards would be wise to heed these words.

However, the reality is that to retain executive talent, some companies will still need to ensure their executives get paid bonuses. Executive retention is a priority for companies looking to stabilize operations and business continuity.

Stakeholders And Compensation

Adapting Pay Plans To New Needs

Stakeholders	Impact on Shareholder Value Creation	Board Considerations
Customers	Serving customers is the purpose of an organization. Companies need to know how their customers are faring, and need to be able to pivot to ensure they are producing products and services that reflect the changing needs of their customer base.	☐ Impact of COVID on customer base. ☐ Change in demand for goods and services. ☐ Ability to pivot and respond to changing customer needs.
Employees	Companies need a diverse and talented pool of employees to produce the products and services that create shareholder value. While this has always been inherent in the value proposition for a company, it is important to elevate the status of employees to reflect their role as critical stakeholders. Companies that properly acknowledge and reward employees for their contributions are more likely to succeed.	☐ Ability of employees to work effectively in the COVID-19 environment. ☐ Support to ensure their health and well-being and, therefore, effectiveness. ☐ Ability of current employees to meet the new talent requirement needs.
Suppliers	The COVID-19 pandemic brought to light weaknesses in supply chains. In an effort to manage costs and maximize short-term profits, companies "squeezed" supply chains. This resulted in unintended consequences, including supporting unfair labor practices and creating risk within the supply chain by sourcing from one country and from long distances. In some cases, the health and well-being of American citizens was in the hands of suppliers on the other side of the world.	☐ Functionality/risks of supply chains. ☐ Effectiveness of management's emergency plan. ☐ Changes required going forward. ☐ Unintended human rights issues imbedded within the supply chain.
Community	The communities in which a company operates can contribute to its success. A company's presence in a community can attract local talent and even a market for the company's services, and over time improve the quality of life for the community's residents.	☐ Company impact on the local community. ☐ Availability of local talent.

☐ ***Shift No. 3: Marketplace disruption and goal setting for 2021.*** For 2021, disruption in the marketplace and the persistent uncertainty around a recovery make it difficult for boards to set reliable and realistic goals. Boards face two significant challenges for selecting incentive performance metrics and setting goals: a high degree of uncertainty in the upcoming year, and the heightened scrutiny and accessibility of information about their decisions. Directors will be well served to use a rigorous framework for selecting metrics. This can help balance the need to ensure real value creation versus the impact of the market on executive pay. This can be accomplished by considering each metric based on its "dimensionality:"

▫ *First dimension:* Metrics that focus on top line revenue, sales, or market share.

□ *Second dimension:* Metrics that focus on not only top line, but also consider expenses. The most prevalent of these metrics are EBITDA, cash flow, net income, or operating margin.

□ *Third dimension:* Metrics that focus on top and bottom line, but also include finance, investment, and capital funding metrics. The most prevalent of these metrics are EPS growth, ROIC, ROE and ROA.

□ *Fourth dimension:* Metrics that represent the first three dimensions, but also include future expectations, converting intrinsic value to fair value. Largely, the only measure that incorporates future expectations is the fair market value of the stock, making total shareholder return (TSR) the most prevalent measure.

□ *Strategic dimensions:* As a final catch-all, there are some other KPIs or strategic goals that do not focus on the financials or stock prices. These important measures are sometimes seen with ESG goals, discretion, and other specific business outcomes.

A balanced portfolio of short and long term incentives can help ensure incentive plans will operate to create long-term value and represent all stakeholders.

Creating a balanced portfolio of incentives (both short and long term) along each of these five dimensions can help to ensure that incentive plans will operate to create long-term company value, and represent all of the stakeholders identified in the Business Roundtable.

There are several actions that can be taken to structure incentive plans to make them more responsive to today's economy:

☐ ***Review peer group.*** Boards may want to consider reevaluating their peer group, especially if their company has undergone a restructuring, reorganization or change in strategy. Having a peer group that accurately reflects the state of their company gives perspective on how they are performing given external market pressures and dynamics.

☐ ***Implement relative performance measures.*** Because goal setting is more challenging in this volatile environment, benchmarking against peer performance is a commonsense approach that boards can employ. Using relative measures in place of absolute company performance measures mitigates the risk of "penalizing" management for circumstances beyond their control. This approach enables the board to evaluate how the executive team performs relative to others under similar external circumstances.

However, it increases the pressure on the selection of peers. Since payouts may be earned for good relative performance but poor absolute performance, it is important to have a good communications plan. If companies decide to use absolute measures, compensation committees should be highly aware of whether goals may be considered too easy to achieve by either proxy advisory firms or investors.

☐ ***Expand performance ranges.*** With the potential for increased volatility of financial indicators, companies should consider an expansion of performance ranges, widening the spread between thresholds, targets and maximums. This may seem counterintuitive because expanding the range could mean lowering the threshold. However, it also means that a higher level of performance is required to earn awards above target, and yields a flatter, less leveraged incentive curve.

☐ ***Lengthen stock holding periods.*** To help ensure that executives are committed to the company's long-term performance, implement longer holding periods and strong ownership guidelines.

For companies struggling to meet performance targets, adjustments may be inevitable. However, compensation committees should consider the unapproving view that proxy advisory firms have for any upward adjustments to annual executive performance incentives. Changes that trigger a negative response from investors could result in further opposition from them down the line.

For companies that are outperforming targets, again, adjustments may also be inevitable. For companies in industries that are performing well, the question is whether bonuses, which may be quite lucrative, should be paid in full. This is a sensitive issue if the goals were exceeded as a result of COVID-19-related circumstances rather than actual executive performance.

While executive retention is an imperative, it is also important not to disenfranchise employees and other stakeholders by paying large incentives to executives while others struggle. Compensation committees need to think about whether and how to talk to the board about downward discretionary adjustments.

Boards are still contending with the ongoing effects of the global pandemic and the lack of certainty around how and when it will come to an end. As such, they have to plan for multiple economic scenarios.

Their role is to ensure that that the company they serve is doing the utmost to provide the goods and services needed and wanted in a way that supports a healthy and robust economy in which Americans can thrive. This means taking a step back to pull all stakeholders into the picture, and make careful decisions based on a full set of information.

Restructuring performance-based compensation programs to reflect the current realities of doing business during a crisis is challenging. At this point, boards likely know the specific imperatives they need to prioritize in order to navigate the COVID-19 pandemic successfully—that includes retaining executive talent.

Balancing the needs and interests of a growing body of stakeholders while steering potentially embattled companies through to stability is no small feat. Compensation committees need to analyze how to successfully drive the company's strategy, via effective compensation plan design. ■

Plain Language: How To Improve Your Company's Disclosure

by Pierre Lebreton

With most corporate disclosure and reporting written by lawyers to meet regulatory requirements, it is not surprising that the tone is often dense, legalistic, and opaque. "Corporate speak" disclosure can exact a price in investor confusion, disinterest and even distrust. Research proves that "plain language" disclosure not only makes for better writing, but also leads to stronger investor relations.

As the effects of COVID-19 continue to pound the economy and create havoc in markets, companies face more uncertainty than ever before. Since April 2020, the U.S. Securities and Exchange Commission has urged companies to provide as much information as is practicable regarding their financial and operating status and planning. High-quality disclosure is essential not only to protect investors, but also to aid the public response to the pandemic by enhancing "valuable communication and coordination across our economy (including between the public and private sectors) as together we pursue the fight against COVID-19."

Over the past decade, companies have shown significant progress in their approach to disclosure documents, including topics addressed, information and presentation. Now, the expectations of corporate disclosure from stakeholders, on every level and across industries, are heightened. As disclosure grows in length, in response to demands for more information on a broader range of topics, it must also grow in clarity.

☐ ***The power of plain language.*** Instinctively, companies know using plain language in corporate disclosure is a good idea—but it can be difficult to put this knowledge into practice. Writers are often burdened with years-old templates for corporate documents, and they struggle to break that mold in favor of something better. Moreover, writers often slip into the technical jargon of their day-to-day work, forgetting their readers may not be subject matter experts. This mistake can lead to heavy, complex documents that are difficult to read and understand.

Over the past 50 years, many studies have linked a specific plain language criterion to reader benefits, such as reading speed, message retention or message comprehension. Studies also have identified tendencies like passive voice and long sentences as destructive to reading comprehension. However, very few studies have taken a statistical approach to plain language as a whole—until now.

Plain language disclosure not only benefits the reader (who understands and remembers the message more easily); it also helps the author—your company.

A new study, *The Effectiveness of Plain Language Proven By Data,* by Labrador and BVA Group, a research and consulting firm, shows distinct benefits to presenting typical corporate disclosures in plain language. In short, people can absorb information faster, are more likely to understand and remember what they read, and therefore view plain language documents more favorably. Companies that produce those documents generate a valuable asset: trust.

Trust is always important. But, in these uncertain times, when boards are making unpopular decisions to fortify their companies for the future, trust is crucial.

The value of plain language also impacts environmental, social and governance (ESG) disclosure. For instance, companies should fully understand the financial and environmental impact when applied to the billions of words read each day by billions of

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people in the course of their professional activities, both online and offline.

According to the indicators measured by our study, plain language increases communication performance. This not only benefits the reader (who understands and remembers the message more easily), it also helps the authors. Our results demonstrate that plain language messages are more effective than, and preferable to, those written in "ordinary language." These results should encourage all companies to adopt this simple yet very effective writing method for corporate communication.

□ *Fast reading.* The study first analyzed efficiency by including eight text samples at roughly 100 words each and asking respondents, "How long do you think it took you to read and understand this text?"

Half of the samples were written in typical corporate-speak, and half were rewritten in plain language. Only 40 percent of the study participants could grasp the typical corporate-speak paragraphs in 30 seconds or less, compared to 60 percent who read the rewritten sections. Bear in mind that the content of these texts was complex to start with.

Keep It Simple

Putting "Plain Language" To Work

Before:

Based on an amendment voted by the extraordinary general meeting of shareholders on May 8, 2020, the Articles of Association of Transparency provide that the annual general meeting of shareholders is held each year within six months from the end of the previous financial year at the Company's registered office or at any other place in the Grand Duchy of Luxembourg as determined by the Board of Directors and indicated in the convening notice.

After:

The Board of Directors determines date, time and location of the annual general meeting of shareholders.*

However, Transparency's Articles of Association provide that the annual general meeting:

- Is always held each year, within six months from the end of the previous financial year;
- Always take place in Luxembourg.

* *Details are provided in the convening notice*

It will not matter that investors can quickly read and understand corporate disclosure if they do not remember critical information when voting or deciding to invest new funds.

The plain language piece performed nearly 50 percent better than the non-plain text, proving fewer words and shorter sentences mean less time spent reading or rereading to understand the text.

□ *Quick understanding.* The study's second area of focus is the increase in perceived clarity. Participants who read the original paragraphs cited, "I understood what I read" 49 percent of the time. Comprehension rose to 68 percent for rewritten sections.

Per a common misconception, some may infer that increased reading speed would hinder comprehension. However, even though participants were reading those samples more quickly, readers are 38 percent more likely to understand text written in plain language.

□ *Better message retention.* The third feature tested was retention, which combines the efficiency and clarity of the text. Although important, it will not matter that investors can quickly read and understand corporate disclosure if they do not remember critical information when voting or deciding to invest new funds. Study participants were asked, "Do you feel that you have memorized key information in this text?"

The results showed participants retained information from the rewritten paragraphs 58 percent of the time, compared to 41 percent for "original" paragraphs. Furthermore, over half of the study participants specifically did not remember the content from "original" sections.

□ *Clarity creates preference.* The previously discussed benefits—fast reading, quick understanding and better message retention—highlight the importance of saving time and making sure the reader understands and remembers messages. This fourth finding addresses the benefits the author experiences

when using plain language. Readers perceive plain language content as clearer, and are more inclined to accept and appreciate the message conveyed.

Plain language delivers the advantages of efficiency, clarity and retention by making documents more inviting and natural to read and understand. In this study, participants found plain language samples "well-written" 64 percent of the time, and "well-organized" 66 percent of the time (compared to 48 percent and 49 percent for the original copy).

As a result, participants were far more likely to call the plain language samples "pleasant" to read (58 percent) than they were to say favorable things about the original samples (41 percent).

The study listed the final question as "What type of text do readers find clearer?" More than 7 out of 10 respondents referred to plain language as clear and showed a preference for corporate disclosure written in plain language. Companies can use this data to understand their readers' subjective feelings better. The results are indisputable—a text written in plain language is subjectively more pleasant to read.

How does this benefit the company disclosing the text? A reader's positive impressions of a document can translate into positive feelings about the company behind the document.

☐ ***The science behind plain language.*** Our study provides a clear outline of why companies should strengthen their corporate disclosure through plain language, and additional sources further support its impact. According to *Sustainability Accounting, Management and Policy Journal,* plain language disclosure is perceived as more truthful, and therefore more credible, especially among readers who are not specialists. This can be specifically impactful for companies with a significant retail shareholder base.

Moreover, Elizabeth A. Ising and Gillian McPhee of Gibson, Dunn & Crutcher LLP provide proxy statement preparation tactics, including considering plain English enhancements to evolve the proxy statement into a shareholder engagement tool. They suggest that all companies would benefit from considering five questions to enhance the readability of their proxy statements: Is it short, skimmable, logical, layered and audience-focused?

For a company's disclosure to be viewed as the primary trusted source of information about the company, another study, *Disclosure Readability and the Sensitivity of Investors' Valuation Judgments to Outside Information,* indicates plain language will help. In this case, investors who read disclosures in typical corporate-speak were less comfortable evaluating the issuing company than those who received the same information in plain language.

To alleviate their discomfort, the investors who read the corporate-speak were more likely to turn to other sources, like news articles and analyst reports. That means companies issuing complex, jargon-filled documents rather than plain language may be squandering an opportunity to focus investors' attention on where they want it.

Hiding details from shareholders never fares well. Plain language makes for more robust understanding and creates a sense of goodwill.

☐ ***Fostering shareholder trust.*** As the COVID-19 pandemic spotlights corporate systems globally, a company's ability to clearly communicate its compliance system is a crucial aspect of earning stakeholders' confidence. Compliance alone is not enough to persuade them. Plain language is essential in presenting a company's governance and compensation story to better attract and engage target audiences.

Some company authors appear to fall into the habit of disguising their text with jargon, convoluted ideas and complicated words to appear more enlightened, or burying negative news the company has to disclose.

The problem with these tactics? Companies lose the impact of being precise. Hiding details from shareholders will never fare well in the long term for shareholder trust and confidence in the company. On the other hand, plain language makes for quick reading, better memorization, more robust understanding and, ultimately, creates a sense of goodwill.

Corporations are obligated to respect their shareholders' time and partner with them by providing the needed information in an easy-to-read and digestible format. The goal, especially during a crisis,

is to quickly, clearly and precisely explain what the company has or has not done.

An added benefit for the company that leads with transparency is the trustworthy reputation they will receive compared to peers that are deploying murky and ineffective corporate disclosure.

One real-time example is plain language disclosure on executive pay. The past year has been anything but "business as usual." In many cases, long-term equity awards granted before March 2020 have lost value, and performance goals for annual bonuses have become unrealistic.

Companies still want their compensation programs to motivate and reward executives' efforts. Yet when so many are furloughing employees and reducing dividends, pre-pandemic incentive pay plans may now seem inappropriate.

Corporate boards are thinking about how to keep incentive plans motivating, engaging and acceptable. A survey by Willis Towers Watson of 681 U.S. companies revealed that many had either revised their incentive plans or are considering revisions. The most common proposed change is adding an element of discretion. This would allow a compensation committee or the full board to adjust incentive awards at the end of the performance period.

However, investors will be wary of companies that exercise discretion, especially with award increases. To mitigate ill will and retain stakeholder trust, companies must prioritize careful disclosure. In addition to thinking about the details they are required to disclose, companies should consider how best to communicate those details to foster stakeholder trust.

As we have shown, trust is always important, but as boards make potentially unpopular decisions in the short term to fortify their companies for the future, it becomes crucial. Companies can take many steps to boost stakeholder confidence, including evaluating the language they use in their disclosure documents.

Rather than overwhelming those documents with corporate-speak, companies should divulge their use of discretion in plain language. They will fare better with their audience and increase the odds that investors will support discretionary changes to executives' incentive awards.

Readers often lack time to review lengthy documents thoroughly, and graphics are essential for easily locating the information.

☐ ***Reader-centric design.*** In addition to the importance of plain language in corporate disclosure, there is an equally important aspect of a transparent document—design.

With readers pressed for time, it is crucial to have a well-structured document that allows them to locate the information they need and quickly digest the content. For example, the cover is the most critical page of the proxy statement, as it is the first opportunity to present brand identity or allow company leadership to engage with readers. It is good practice to use the inside of the front cover instead of leaving it blank. Design this space to offer an easy-to-find table of contents or highlight the company mission and values.

Furthermore, it has become a standard best practice to add visual elements to proxy statements, including the use of graphics, charts and images. Again, readers often lack time to review lengthy documents thoroughly, and graphics are essential for easily locating the information and metrics they need.

Investors want to know if a company's governance is strong enough to weather a crisis like the COVID-19 pandemic. How does the company manage human capital?

Labrador's latest *Transparency Awards* rank the top S&P 250 companies by the quality and completeness of information U.S. companies make available to investors. The 2020 company rankings were determined through review of annual proxy statements, annual reports on Form 10-K, investor relations websites and codes of conduct. Companies were scored using 129 discrete criteria based on the four pillars of transparency: accessibility, precision, comparability and availability.

Why is it important for companies to take stock of their corporate disclosure? The consequences of a crisis such as the COVID-19 pandemic on businesses are far-reaching, and affect all areas of corporate

disclosure. Is a company's governance strong enough to weather such a crisis? How does the company manage human capital? What about its compensation program? Does it need adjustments, and if so, how should it explain them to its shareholders? The criteria used in these rankings allow companies to answer questions both transparently and efficiently.

The analysis shows The Allstate Corporation scored the highest for best overall corporate disclosure. Allstate differentiated themselves through a number of criteria. These include providing access to the company's latest earnings presentations within the investor relations website, noting diversity as a priority within the proxy, and citing five or more themes within the Code of Conduct.

According to the Illinois-based company's latest proxy statement:

"Allstate has a history of strong corporate governance guided by three primary principles: dialogue, transparency and responsiveness. The board has enhanced governance policies over time to align with best practices, drive sustained stockholder value and serve the interests of stockholders."

As we continue to move through 2021, precise and careful disclosure will maintain importance. Companies must prioritize thoughtful and transparent disclosure, adapting and innovating how they communicate to shareholders. Also, investors, regulators, media, proxy advisors and trade partners will be more favorably inclined toward a company when it communicates in plain language. As proven in our study, people are more likely to read, understand, believe and remember such disclosure. Most importantly, they are more likely to come away with a positive impression and trust. ■

Board Effectiveness: A View From The C-Suite

by Maria Moats and Paul Washington

Board self-assessment has become a crucial element in improving a company's corporate governance. But there are "experts" at your company with first-hand knowledge of your directors' strengths and weaknesses whose input is rarely sought in evaluation—executives who work with the board. What follows is survey results sharing the C-suite's unfiltered view of their board of directors.

For almost two decades, PwC's Annual Corporate Directors Survey has compiled board members' views on governance, their own performance, the performance of their peers, and the performance of their management teams. For 2020, PwC joined with The Conference Board to turn the spotlight on management's views. We surveyed over 550 public company C-suite executives to gather their opinions about the performance of their company's board of directors. The results surprised us.

Forty-one percent of executives say their board falls short on overall effectiveness.

Because of the nature of the board's oversight role, management typically has very little opportunity to give "upward feedback" to its directors. What they see is a gap between, on one hand, the deep understanding directors have of the company, and on the other, its effectiveness. By and large, executives say that directors "get it." They understand not just the company's strategy and business risks, but also its shareholder base, competitive landscape, corporate culture, and talent pipeline. However, from the perspective of many executives, that is not enough.

Forty-one percent of executives say their board falls short on overall effectiveness. They voice concerns including directors' lack of preparedness, over-boarding, and aging board members who are not as effective as they once were. While they give boards high marks in areas such as financial and operational expertise, they also find certain expertise is missing. This is especially true in specialized areas like IT, ESG, and crisis management.

So it is not surprising that management wants to see board refreshment. More than four out of five executives think that at least one director on the board needs to be replaced.

Boards are, and should remain, largely independent from management. They are not directly accountable to their executive teams and should not be afraid of acting in ways that displease them. However, the findings from this survey point to some of the ways in which boards, and their management teams, can enhance both substance and perception of board performance.

☐ ***Directors are in sync with company challenges and goals.*** From their seat in the boardroom, it can be a challenge for directors to fully grasp the day-to-day at a company. Directors are not present at the company every day and are there to provide oversight, not management. Yet executives praise their directors' understanding of the company and the way it operates.

More than 9 out of 10 executives (94 percent) say that the board understands the company strategy somewhat or very well. Eighty-nine percent say the same about the company's top business risks, and between 85 percent and 87 percent of executives think the board has a good understanding of the shareholder base, competitive landscape, culture, and talent development and pipeline. Many of these are areas that have received special attention in recent years, as boards have pushed for more reporting and

Maria Moats *is the leader of PwC's Governance Insights Center, and* **Paul Washington** *executive director of The Conference Board's ESG Center.*

a better understanding of internal operations. That work has paid dividends.

Still, company executives believe the area that directors understand least is its crisis response plan. About three-quarters (73 percent) of executives surveyed said that their crisis management plans were also inadequate to the challenges of the time. Boards need to be able to judge whether the company was prepared for a crisis before it happened, whether the right people were involved, and whether the response was effective.

Since executives may have limited interaction with board members, this could lead to a lack of understanding about the board's oversight function.

☐ ***Executives say boards miss the mark on overall effectiveness.*** According to management, directors have a good grasp of what is going on at the company. While a majority rate their board's overall effectiveness as good (43 percent) or excellent (16 percent), a surprising percentage give a grade of fair (33 percent) or poor (7 percent). Where is the disconnect between management's views of the board's *understanding* and its perception of board *performance*?

This gap may be linked to some of the complaints we heard from executives, including unprepared or overburdened board members and disappointing levels of expertise in many areas. The latter may be especially true when it comes to IT. Executives in IT roles were the most critical of board members, with almost three-quarters (74 percent) giving the board a grade of fair or poor, compared to just 25 percent from the office of the CEO or CFO giving similar assessments. Yet since executives in this area may have more limited interaction with the board, it could also reflect a lack of understanding about the board's role and directors' general oversight function.

☐ ***According to the C-suite, directors are not doing their homework.*** The job of a director is a challenging one. It requires oversight without micromanagement, and perspective without the daily details, Directors are not involved in everyday details, but are expected to have a strong understanding of the entire company. They rely heavily on their management teams to help do their jobs.

When asked about directors' overall engagement and preparation, management sees room for improvement. A slight majority say that the board is not overstepping its role and is spending sufficient time in its role (54 percent and 53 percent, respectively). Fewer (46 percent) see probing questions from the board, and only 37 percent say that members come to meetings fully prepared. Among executives in IT roles, only 7 percent think their board members are prepared.

The global COVID-19 pandemic and related economic crisis may have contributed to this perception. The crises companies have faced have led to an increased volume of board reporting and materials. Directors may have been asked to address topics relating to employee and customer health and safety that had not previously been a focus of board attention.

There is a gap between how boards and management perceive the performance of individual directors, with management seeing more room for improvement.

☐ ***More than 80 percent of executives think a member of their board should be replaced.*** In PwC's Annual Corporate Directors Survey, almost half of directors (49 percent) tell us that one or more of their fellow board members should be replaced. This figure indicates that directors themselves see the need for turnover on boards.

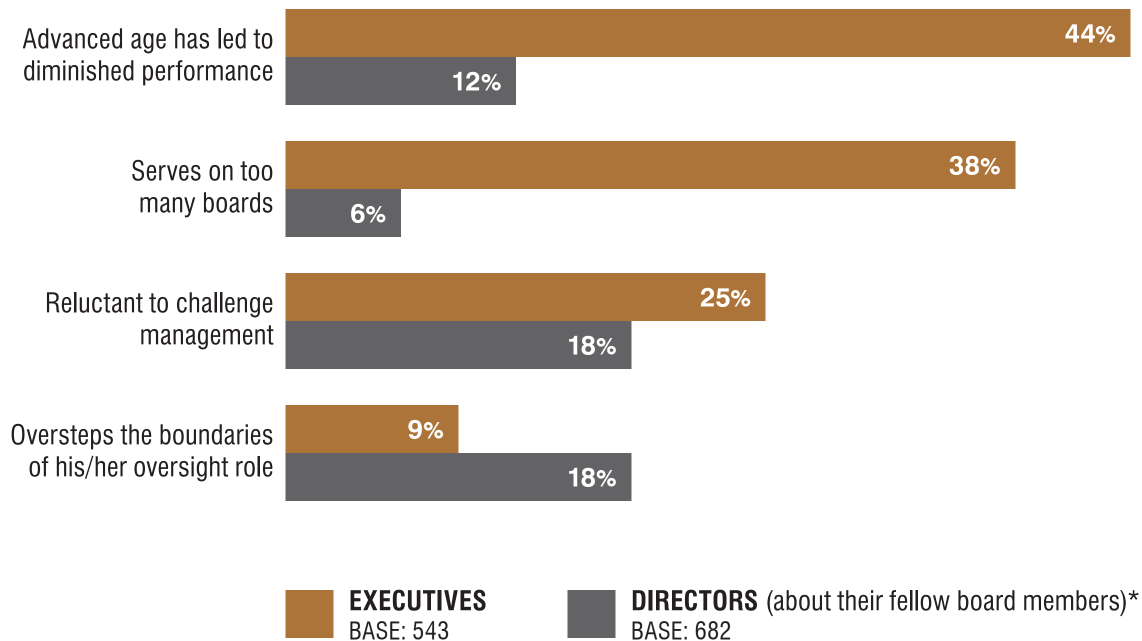
Even more executives are looking for change. Eighty-two percent say that at least one director on their board should be replaced. Forty-three percent (43 percent) think that two or more members should go, compared to 21 percent of directors. By comparison, the average turnover on S&P 500 and Russell 3000 boards is less than one director per year.

There is a gap between how boards and management perceive the performance of individual directors, with management seeing more room for improvement. While the desire for board turnover is

Boardroom Blind Spots

Executives And Directors See Different Issues On Boards

Do you believe any of the following about any of your company's/fellow board members? (select all that apply)



Results for directors are based on responses to PwC's 2020 Annual Corporate Directors Survey

most pronounced among members of management who may have limited interaction with boards, 31 percent of CEOs and CFOs and 40 percent of chief legal officers support replacing two or more directors.

Executives are less likely than directors to think that board members overstep their oversight authority.

☐ ***Executives are concerned about director age and bandwidth.*** A number of executives express concern about their directors' ability to contribute to boardroom deliberations. Forty-four percent of executives say diminished performance due to director age is an issue on their board (something that directors do not see as a particular problem). Thirty-eight percent say that directors serve on too many boards. That is consistent with shareholder concerns about overboarding, even as relatively few directors say they see overboarding as an issue among their peers.

On the other hand, executives are less likely than directors to think that board members overstep their oversight authority. This is among the most common complaints from directors (18 percent), but only 9 percent of executives identify it as a problem. They are more likely to say that their board is reluctant to challenge management (25 percent vs. 18 percent of directors). In particular, executives say that the board should be more willing to challenge management on its crisis preparedness.

☐ ***Management questions directors' expertise.*** Director recruitment is often driven by the need for certain skills, experiences, and expertise. Directors often view themselves and their peers as experts in

The C-Suite Wants More

Tips For Directors And Executives

Confident that their boards understand the company's business, executives view the board as a strategic resource, and they want more from their directors. More expertise, more preparation, and more engagement in critical areas. Some tips for directors—and management—to help boards meet that challenge.

Board performance evaluations.

☐ *Directors:* Reassess the board and committee self-evaluation processes, including considering the best way to receive input from management on how the board as a whole is adding value, and areas they may need to improve in or spend more (or less) time on.

☐ *Management:* As part of the board evaluation process, seek feedback from directors on how agenda, materials, and presentations could be improved, so that you can make it easier for the board to fully engage.

Board education.

☐ *Directors:* Keep up the good work by continuing to stay on top of key company issues in the boardroom. Take advantage of other opportunities to deepen your understanding of more specialized topics outside meetings. Contact management in advance of a meeting if the material you have received assumes knowledge you lack, or uses terms that are unfamiliar, or if you want a deeper conversation with management or a company consultant.

☐ *Management:* Ensure that the board has the right baseline information to be effective. Directors are not living these issues every day and need not be subject matter experts in every area, but they may benefit from educational sessions from management and from outside advisers. Make sure that executives with specialized expertise can speak effectively to the board in terms that an educated layperson can understand.

☐ *Directors and management:* Work together to increase interaction and elevate board transparency, as seen from those in the C-suite. Ensure that members of the executive management team have more insight into board operations, how the board functions and why, so management can provide the support the board needs.

Board composition.

☐ *Directors:* Focus on succession planning. If a clear board succession plan is not already in place, make that a priority. This may not mean immediate changes, but the board should know where it is going and feel that it is responsible for determining what skills are needed in the future. Boards should also take a hard look at their own directors and determine whether some are spread too thin, or whether any directors are no longer bringing the right skills and expertise to the table.

☐ *Management:* Contribute insights about what the board might be missing and where to focus in the future. Suggestions about adopting or revising refreshment policies may be appropriate, including examining the board's retirement age and/or tenure policy.

Crisis management.

☐ *Directors and management:* Consider different types of crises and the board's role in each. For example, in significant cyber attacks, management takes the lead and the board does not have a direct role, but the board should be notified along the way, and involved in major policy decisions. Take a retrospective look at the first part of the crisis presented by COVID-19 to find ways to improve the board's and management's responses.

☐ *Directors:* Each crisis is different, so have a process in place for determining the most effective way for the board to stay on top of unfolding events. The board chair, lead independent director, and committee chairs can be invaluable in helping to decide how to keep the board informed and involved—including whether a special committee should be formed.

certain areas. This mix helps to create a well-rounded and high-functioning board. Yet executives are not convinced of their board members' subject matter expertise. They gave the highest marks in operations and finance, with nearly two-thirds saying the board's expertise is good or excellent.

In other areas, however, the numbers were lower. Less than half ranked director expertise as good or excellent in areas like IT/digital/data privacy (48 percent), ESG (47 percent), and cyber risk (46 percent). Crisis management expertise is also a particular area of concern, with only 37 percent of executives giving

a positive score to their directors' level of expertise.

☐ ***Finding common ground on board diversity.*** For years, as institutional investors have pushed boards to consider and improve their board diversity, directors themselves have reported seeing the value of that diversity. The vast majority of them say that board diversity brings unique perspectives to the boardroom and that it enhances board performance.

Executives' views of board diversity are similar. Eighty-eight percent of executives say that board diversity brings unique perspectives to the boardroom, and 86 percent agree that it enhances board performance. Executives are even more likely to say that diversity improves the board's strategy and risk oversight (83 percent), compared to 71 percent of board members. Executives are also slightly more likely than board members to say that diversity enhances company performance.

☐ ***C-suite concerns with crisis management oversight.*** As an area of board oversight, the C-suite finds crisis management lacking. It is the oversight area that executives say directors understand the least, with only 57 percent giving directors a positive rating. Only 37 percent of executives said the board has good or excellent crisis management expertise—the lowest figure in any category. Almost half (48 percent) say that crisis preparedness is an area where directors need to challenge management more, making it the number one response. Moreover, less than one-third of executives (30 percent) say their boards respond well in a crisis.

With the pandemic highlighting gaps in crisis management at both the board and management levels, companies cannot waste this opportunity to learn from their crisis response and to be better prepared for when the next crisis hits. ■

D&O Coverage In A Time Of Turmoil

by Shanil Williams

A global pandemic, market volatility, ESG concerns and cutbacks have left many businesses in stress over the past year. These factors have also made them more vulnerable to shareholder suits against their directors and officers. How have your liability threats changed in the new normal? Is your D&O coverage still up to the task?

In what has been a volatile year for global markets and corporate officers—from the pandemic to business lockdowns to political upheaval to warnings of forthcoming insolvencies—boards, more than ever, are vulnerable to a litany of business exposures. Any of these could potentially derail the financial health and continued service of a company. Following are five directors and officers (D&O) insurance mega trends to watch for in 2021.

☐ ***1. Global economic developments and insolvency exposure.*** As the world continues in the throes of economic downtown and a disruptive coronavirus pandemic, the 2021 economic and political outlook is highly volatile. While the International Monetary Fund (IMF) expects the global economy will have shrunk 4.9 percent in 2020, on the one hand, it projects a 5.4 percent global growth in 2021 on the other hand—far below its pre-pandemic projections.

Historically, insolvency is a key cause of D&O claims, as insolvency practitioners look to recoup losses from directors. There are many ways that stakeholders can go after directors following insolvency, such as alleging that boards failed to prepare adequately for a pandemic or for prolonged periods of reduced income.

There were six "mega" bankruptcy filings involving businesses with at least $1 billion in reported assets during the first quarter of 2020, 31 in the second, and 15 in the third. The total came to 52, compared with a 2005 to 2019 quarterly average of five, according to a report by Cornerstone Research Inc.

According to Euler Hermes, the bulk of insolvencies is still to come, with its global insolvency index likely to hit a record high for bankruptcies, up 35 percent by the end of the year. The top increases are expected to be recorded in the U.S. (up 57 percent by 2021, compared to 2019), Brazil (up 45 percent), and China (up 40 percent).

COVID-19 means longer payment delays and rising inventories among large corporations. Global firms' liquidity needs will increase by five days to 74 days in 2020, or $8 trillion (up $140 billion). Monetary policy and successful vaccinations are the remaining safety nets for growth and avoiding substantially more insolvencies and probable recession.

New IPOs dramatically increased at the end of 2020, suggesting a wave of new IPO-related securities litigation in the not too distant future.

☐ ***2. Securities class action activity and the impact of COVID-19.*** Through the first half of 2020, new U.S. securities class action filings were approximately 18 percent behind rates seen in 2019. This downturn was due in part to the disruption to businesses and court activity caused by the COVID-19 pandemic. Nonetheless, the frequency of federal court filings is on track to match rates in 2017 and 2018, and will be well in excess of every year prior to those.

About half of the new filings have been against Asia-domiciled companies (13 from China and three from Singapore in the first half of 2020). As in the previous year, Canadian companies have also been a frequent target (particularly cannabis companies). Financial services, technology and healthcare/pharmaceutical firms have been impacted most frequently.

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Meanwhile, new merger-objection suits declined, as the pandemic appears to have depressed merger activity during the middle part of 2020. On the other hand, new initial public offerings (IPOs) dramatically increased at the end of 2020, suggesting a wave of new IPO-related securities litigation in the not too distant future.

Approximately 20 percent of U.S. IPOs launched between 2009 and 2018 gave rise to securities class action suits within four years of the offering, and more than 30 percent within eight years. Companies whose share price drops below the initial offering price have a measurable risk of drawing securities class action litigation.

Another looming liability threat comes from COVID-19 return to work steps taken by businesses.

Shareholders filed more than 20 U.S. securities class action lawsuits related to COVID-19 through October 2020, although observers differ on whether or not certain actions are related to COVID-19. Examples of suits to date include against cruise ship lines that suffered COVID-19 outbreaks, as well as litigation regarding the business impact of the pandemic on companies' financial performance or operations. Investors also filed claims against firms that have made misrepresentations about coronavirus-related therapies, testing, or equipment; there has also been a number of consumer class actions following a failure to reimburse customers.

While this may be a smaller figure than might have been anticipated near the outset of the pandemic, the current increase of new bankruptcy filings likely will add to the number of lawsuits stemming from the pandemic.

Another threat looming on the horizon comes from the return to work steps taken by businesses, which will ramp up in the near future. The return to office is fraught with peril, with particular regard to shareholder derivative actions, but also to other forms of litigation. Employers can be in a tough spot when asking employees to return, and on deciding which ones to choose. Employers can be restricted by regulations on what they can ask and how they can act.

In addition, those companies which are slower to recover from the pandemic compared to industry competitors could leave themselves open for litigation from shareholders and consumers alike claiming underperformance.

Outside of COVID-19, the past year gave rise to some positive legal developments. Both the Delaware Supreme Court and a trial level court in northern California upheld forum selection provisions in corporate charters. These require shareholders to bring actions exclusively in federal court for alleged violations of the Securities Act of 1933 related to shares offered in IPOs.

Corporations began to adopt such provisions in reaction to the U.S. Supreme Court's 2018 decision in *Cyan, Inc. v. Beaver County Employees Retirement Fund,* which affirmed the concurrent jurisdiction of federal and state courts over 1993 Act claims. While a significant percentage of U.S. corporations are incorporated in Delaware, it remains to be seen whether states other than Delaware and California, as well as non-U.S. jurisdictions, will uphold such forum selection provisions.

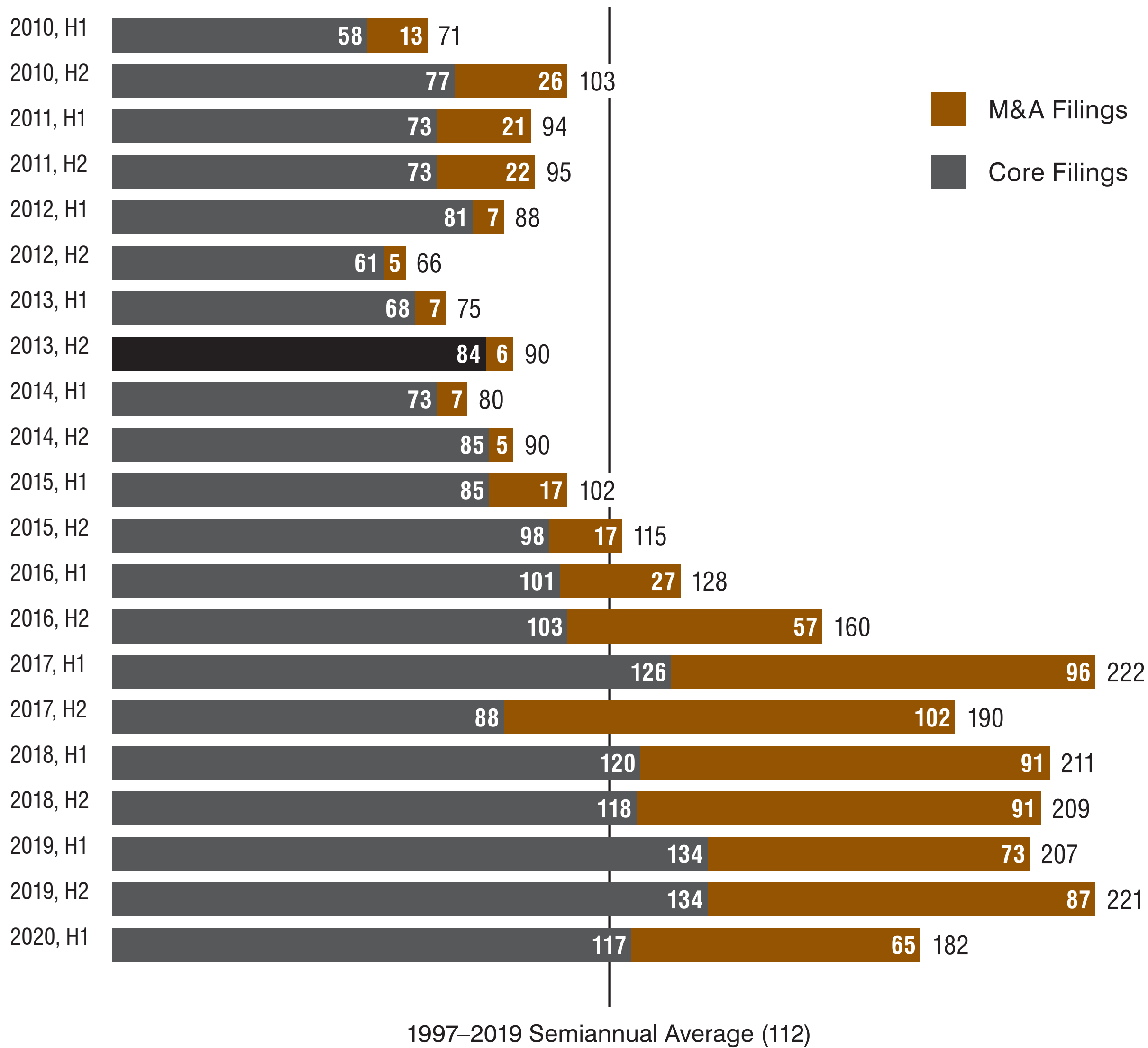
Outside the U.S., securities class actions are being filed in record numbers, and the threat has increased in many jurisdictions, notably in Australia and Canada. This is also seen in consumer-facing sectors such as retail, automotive, insurance, pharmaceutical and financial services.

The landscape for collective redress in Europe has evolved over the last few years, and is a growing exposure. Many countries now offer some form of collective action mechanism, even if it is just a process for consolidating linked actions rather than a true procedure, and such tools are being used.

☐ ***3. Cyber attacks and the boardroom.*** Companies face an evolving landscape of cyber security threats, including potential vulnerabilities caused by the increase in remote working due to COVID-19. Investors view cyber security risk management as a critical part of the board's risk oversight responsibilities. There has been a dramatic increase in the

The D&O Storm Continues

Semiannual Number Of Class Action Filings, 2010-2020



Note: This figure begins including state 1993 Act filings in the semiannual counts in 2010. Parallel class actions are only reflected as a single filing. When parallel cases are filed in different years, the earlier filing is reflected in the figure above. Accordingly, counts that include parallel filings may differ from counts of state filings because a parallel filing may be counted in a prior year.

Source: Cornerstone Research, Securities Class Action Filings 2020 Midyear Assessment 2020

number of incidents, and significant numbers of data breaches have occurred in the health/medical, corporate, government/military, education and financial services sectors.

Often the aftermath of data breaches has been devastating to the companies affected, including fines, costly breach notification procedures, business interruption and intensely negative publicity.

Globally, directors have been called to account, including in derivative and direct litigation, for alleged failures to protect against cyber security risk. Moreover, major breaches experienced by publicly-traded

firms have damaged investor confidence, causing rapid share price drops. These become "events" which give rise to costly class action securities litigation.

In future, more and more D&O claims are likely to be driven by environmental, social and governance (ESG) factors.

□ ***4. Diversity, climate change and ESG factors.*** Oracle, Facebook, Qualcomm and Norton LifeLock are technology companies which faced board diversity derivative suits—specifically, that their boards lack black directors.

The common background of these derivative suits seems to be a reaction to racial justice protests such as "Black Lives Matter," and the complaints in the lawsuits are similar. Shareholders allege that the company's board violated their fiduciary duties by their inaction on diversity issues. Some of the complaints seek actions such as return of board members' remuneration, nomination of new black board directors, creation of a company fund to hire black talent or aiming to tie executive pay to diversity-related goals.

While the financial impact of these lawsuits remains to be seen, there will be substantial legal defense costs involved in their settlement. This growing D&O liability threat may further drive increases in the frequency and severity of U.S. securities class actions.

In future, more and more D&O claims are likely to be driven by environmental, social and governance (ESG) factors, which have the potential to substantially impact the reputation of a company.

This trend may be seen as a continuation of the rise of D&O "event-driven litigation." Plaintiff law firms are ready to seize the opportunity to bring class actions or force a settlement. The "event" itself can be caused by different triggers. The *#MeToo movement,* COVID-19, the California wildfires, an airplane crash and ESG are a few.

Issues resulting from climate change, water management, biodiversity degradation, exploitation in supply chains and corporate governance are some of the main ESG trends to watch in 2021. From a D&O liability perspective, these are topics which companies and boards will be expected to focus on for disclosure and internal risk management. The accountability of risk managers is rapidly evolving in this context, for example, through identification of the key risks to the company and the most effective mitigation measures.

Climate-linked activism against corporations is a developing trend, particularly in Europe. Boards are increasingly challenged by investors and stakeholders.

Climate change is a key challenge. Since the 1980s, the frequency of natural catastrophes worldwide has tripled. The economic impact of extreme weather events in G20 economies alone is estimated to be $142 billion annually. Climate change cases targeting "carbon majors" have already been brought in more than 30 countries. Most are filed in the U.S., where an increasing number allege that companies have failed to adjust business practices in line with changing climate conditions.

Climate-linked activism against corporations is a developing trend, particularly in Europe, and boards are increasingly challenged by investors and stakeholders. To understand the real impact of climate change, companies and their boards have to look beyond the usual two- to five-year horizon, and anticipate and prepare for various future scenarios.

The new modelling approach focuses on both ESG-related metrics such as corporate governance, and other quality parameters, including compliance standards. The data show that specific ESG performance indicators are strong predictors of future D&O litigation.

D&O underwriters need to be aware of ongoing global ESG matters—from activist investor campaigns to social justice protests or money laundering schemes—in order to adequately assess potential perils. Ultimately, underwriters must assess how these matters may develop into a litigation trend and/or impact a company's risk management practices.

□ ***5. Private company exposures continue to challenge directors and officers.*** The importance

of D&O insurance to private companies is generally understated. The majority of private company lawsuits are employee-related matters. However, a private company's officers can be sued for breaching their fiduciary duties, such as sale of a company for an alleged inadequate price. Other examples of why private companies should have D&O coverage are to combat anti-trust claims and regulatory actions. Private companies and their senior management also need to be aware of the potential liability risk under federal securities regulations for alleged misrepresentations to prospective investors and others.

While these settlements can be relatively small when compared to public companies, they may have a huge impact for executives who are made personally liable and who lack D&O protection. This is even more concerning in the context of bankruptcy, where executives are made liable at a point in time when the company itself is unable to indemnify them.

Generally, directors and officers for privately-held companies are more closely involved in all of the company's operational topics and business decisions. This may more easily translate into the direct, personal imact of different types of litigation impacting them.

The COVID-19 pandemic is currently placing private companies and their executives under considerably higher D&O litigation risk. Today's business decisions will have a long-term impact on the risk management practices, internal processes and management of labor and IT resources.

Companies and brokers are trying to bring the supply and demand back into equilibriu. Companies are focusing more on the Side A part of D&O coverage, and taking more of the Side B and Side C on their own balance sheet.

☐ ***Market dynamics—the state of the D&O sector.*** Although billions of dollars' worth of premiums are collected annually for D&O insurance, the profitability of the sector has been hit in recent years, due to increasing competition, growth in the number of lawsuits and rising claims frequency and severity. Underwriting results have been negative in many markets around the world, including Australia, the U.K., the U.S. and parts of Europe. This has been compounded by a cultural shift that has resulted in more D&O claims being brought around the world.

Third-party data suggest the D&O market continues to harden in terms of pricing, the combination of previous pricing inadequacy and exposure, and loss trend increases during the soft market cycle.

From an insurance-purchasing perspective, companies and brokers are beginning to explore different insurance options to try and bring the supply and demand back to equilibrium. These include retaining much more risk at the frequency and low severity side via increased self-insured retentions, co-insurance and even alternative risk transfer options.

In addition, companies are focusing more on the Side A part of the coverage, and taking more of the Side B and Side C on their own balance sheet. As companies have increasing budget restrictions in 2021, we may see more of a focus on retention levels and coverage which has a trade off with premium.

D&O insurance is a boardroom issue, and this product is one which requires an elevated level of partnership between customers and carriers.

As for the impact of COVID-19 on claims, traditional class action lawsuits (which had decreased as the pandemic settled in from March to May) have picked up and will likely continue through 2021, especially against companies in sectors like transportation, leisure, biotech and banks. After years of abundant capacity and appealing rates, D&O underwriters had anticipated a hardening market in 2020—and then the pandemic hit. The D&O market is watching very carefully what happens from here through the end of 2021. ■

Best Practices For Virtual Shareholder Meetings

by Douglas K. Chia and Ann S. Lee

Taking annual shareholder meetings online was uncommon and controversial in 2019, but the COVID-19 crisis made it the new default model for 2020. As for 2021, annual meetings will continue to go electronic. What lessons did companies learn last year, and how will they guide this year's VSM best practice?

The unprecedented halt to the U.S. and global economies (as well as normal social engagement) caused by the COVID-19 pandemic have had reverberating impacts within corporate America, including on annual meetings of shareholders. Many companies found themselves forced to move annual meetings online with little time to organize and notify shareholders.

In that process, companies, shareholders, corporate governance advisors, and service providers all experienced many challenges, including un familiarity with remote shareholder meetings, novel legal compliance issues, and unanticipated logistical hurdles before and during the annual meetings.

By early 2020, it was clear virtual shareholder meeting technology would be the safest way for most companies to hold their annual meetings.

The 2020 proxy season saw a tidal wave of annual meetings held through virtual platforms (almost 2,500) as a direct result of the COVID-19 pandemic and related health concerns. By the beginning of March, public companies started to realize their in-person annual meetings were scheduled to take place during what medical experts projected would be the most dangerous months of the pandemic: April through June. It was clear that virtual shareholder meeting (VSM) technology would be the safest way most companies could hold their annual meetings on the originally dates.

There were numerous VSM practices during the 2020 proxy season that shareholders will likely expect companies to treat as standard going forward. Other practices appear to be evolving in ways that indicate they will likely become standard in the relatively near term, as VSM technology continues to improve and become more affordable for companies of all sizes.

Companies using a VSM format should explain in proxy materials why they have elected to hold a VSM instead of an in-person meeting.

☐ ***Disclosure.***

▫ *Instructions on how shareholders can attend and participate.* Companies have a responsibility to provide clear and comprehensive instructions in proxy statements and related disclosure on how their shareholders can participate in their shareholder meetings. Therefore, it is incumbent upon the company holding a VSM to provide shareholders with complete, detailed instructions on how they can attend the meeting and vote prior to and at the meeting. Write these instructions in "plain English" with the individual retail shareholder in mind and place them in a prominent and easily located place in the proxy statement for the meeting.

Clearly distinguish and explain the different procedures for shareholders of record and shareholders holding shares in "street name," if applicable. Highlight whether and why a shareholder must obtain and/or provide additional information (separate control number, legal proxy) in advance of the meeting, and how to do so. Also, indicate whether attendance is

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limited to shareholders, or open to both shareholders and guests.

▫ *Instruction on how shareholders can submit questions.* While it is not explicitly a legal right, shareholders expect to be able to ask questions at shareholder meetings, and companies have long included time for questions from shareholders. Companies frequently have meeting rules distributed at in-person meetings, and this should be no different for VSMs.

Companies should provide instructions on how and when shareholders will be able to ask questions at the meeting. Make it clear that a shareholder must attend as a verified shareholder (not as a guest) to be eligible to ask questions and vote.

Explain any requirements or limitations on asking questions at the meeting (such as time allotted, number of questions allowed for each shareholder, and self-identification) and how the company may use discretion when selecting questions to answer and paraphrase questions for greater clarity. Explain whether and how the company will respond to any questions after the meeting that it was not able to answer.

If the company chooses to solicit questions in advance, provide instructions on how shareholders can ask questions in advance of the meeting.

▫ *Reasons for using a virtual-only format.* VSMs have not been the norm and were used very infrequently before the COVID-19 pandemic. Shareholders should receive an explanation of why the company has chosen this format for the particular meeting. Companies using a VSM format should explain in proxy materials why the company elected to hold the meeting using a VSM format instead of in person.

It is important to anticipate and work out as many potential technical difficulties as possible well in advance of a VSM.

☐ ***Preparation.***

▫ *Company training and rehearsals.* As with all planned events, it is important for those directly involved with the VSM to execute their duties, know what to expect, and anticipate and work out as many potential technical and communications difficulties as possible well in advance.

To that end, the company should ensure adequate training on the VSM platform for any board members, company representatives, and contractors who will be actively participating. Ensure the adequacy and functionality of all communication media, and have technical support staff present during the meeting in case technical challenges arise. Rehearse the entire meeting with those who will be actively involved.

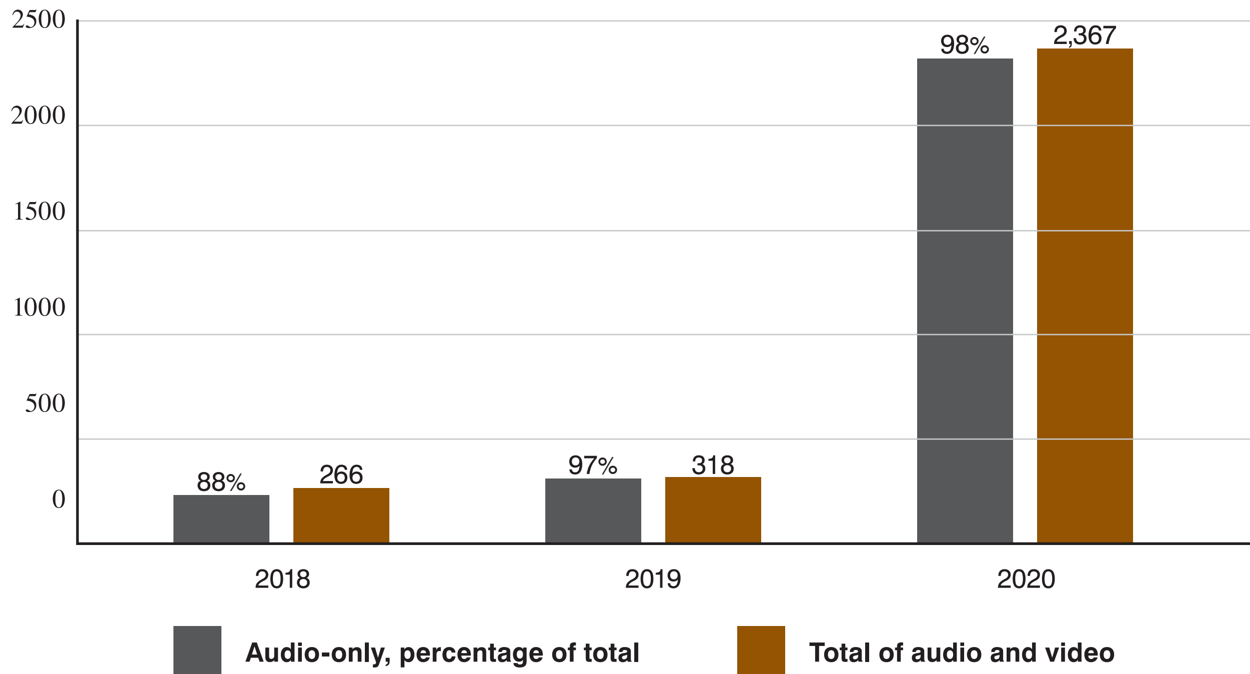
▫ *Communication with shareholder proponents.* Preparation for any shareholder meeting should include direct communication with any shareholders that have proposals to be voted on at the meeting. For VSMs, it is important that shareholder proponents are given access to formally present their proposals, be heard clearly and uninterrupted by all attendees, and fully able to participate in any Q&A session.

Companies should coordinate with proponents in advance to discuss the logistics of presenting their proposals and subsequently asking questions. Provide proponents with a dedicated phone or video connection to present their proposals in real time at the meeting. Test the connection on both sides in advance.

Give proponents the option to provide a prerecorded statement that the company will play, or a written statement for management to read aloud, at the meeting in lieu of virtual attendance. Ensure they are aware of the meeting agenda, when their proposals will be introduced, how they will know when to speak, any time or length limitation for their statements, and other instructions needed.

Discuss contingency plans in the event the proponent faces technical difficulties attending the meeting. It is also important for shareholder proponents to make themselves available and be cooperative with advance preparation requests.

▫ *Allow shareholders to test internet connectivity.* Companies should provide a simple way for attendees to check online compatibility requirements (operating system, web browser, and Internet connection strength) to connect to the VSM well in advance. Allow attendees to login at least 15 minutes before the scheduled start time to resolve connection issues.



☐ ***VSM platform.***

▫ *Audio or video format.* Most VSMs thus far have been audio only. A number of companies have conducted their VSMs with both audio and video. The meeting chair and company participants are shown live and in real time from a studio or meeting room, replicating how an in-person meeting would look. However, the pandemic caused most of these companies to also conduct their VSMs using only audio. The hope of investors is that more VSMs will use video. The companies' view is that video can be considered only as production costs and risks of complications decrease, production standards change, and VSM platforms enable multiple people to appear from different locations. To maximize the effectiveness of remote communication, companies should weigh the costs and benefits of video versus audio-only technology, with the aspiration to use video in some capacity.

▫ *Voting.* Voting is a shareholder's most important and powerful right. To that end, companies must provide a prominently visible and simple mechanism on the main VSM page for shareholders to vote their shares, and change their votes if desired, during the time the polls are open. Confirm that the VSM service provider is able to maintain the integrity of, and the inspector of election is able to certify, the votes cast at the meeting.

▫ *Questions.* At an in-person meeting, questions are usually not solicited until the Q&A session begins. This is typically after consideration of the official items of business and any management presentations. During an in-person Q&A session, shareholders asking questions are recognized from the floor by the meeting chair and are seen and heard by the company and the other attendees. Most companies require shareholders to identify themselves before speaking.

For VSMs, the process for submitting questions is very different. VSM platforms usually provide a space for shareholders to type and submit questions during the meeting. The company collects those

questions, and reads and addresses them during the Q&A session as time permits.

To replicate as closely as possible an in-person Q&A session, companies should provide a prominently visible and simple mechanism on the main VSM page for shareholders to submit questions to the company throughout the meeting. Clearly instruct shareholders that when submitting questions, they must identify themselves and provide contact information in case the company needs to address their question after the meeting.

Request that the service provider make all questions visible to the company verbatim and in real time and that they authenticate the identity of the shareholder.

▫ *Posted content.* It is essential that shareholders have all material information needed to make a voting decision. Also, most states require companies to make the list of shareholders of record entitled to vote available at the meeting for inspection.

Post complete and downloadable copies of the meeting agenda, rules of order, and proxy materials for the meeting in a prominent location on the main VSM page. Provide a clear way for registered shareholders in attendance to be able to examine the list of registered shareholders entitled to vote, if required.

☐ ***Assistance for attendees.***

As with any webcast or virtual meeting, there may be instances where attendees face technical difficulties and seek immediate assistance during the meeting. Companies using a VSM platform should provide information in advance of the meeting for how shareholders can contact the company or the service provider with questions. There should be a visible mechanism on each page of the VSM platform for attendees to contact a live operator for assistance via phone, online "chat" function, or other form of real-time communication.

☐ ***Proceedings of the meeting.***

The formal legal portion of a VSM should be conducted in the same manner as any in-person shareholder meeting, with certain modifications or enhancements described below.

▫ *Announcements.* At any large meeting, it is important to provide clear guidance on how the meeting will be conducted and instructions for how to participate. This may be even more important at virtual events. In addition to the usual announcements made at annual meetings, companies should also announce instructions on how to vote during the meeting through the VSM site and proxy materials should be available on the VSM site. Announce how and when to submit questions during the meeting and how and when they will be answered (including the need for questioners' name and contact information).

▫ *Shareholder proposals.* Filing shareholder proposals is an important way for shareholders to express their concerns to the board and to other shareholders. Shareholder votes on these proposals measure the level of support for the board to act in accordance with prevailing shareholder sentiment.

To ensure that shareholder proponents are able to present their proposals properly, companies should encourage the proponent to connect to the meeting through a dedicated line before the meeting begins. Be clear in instructing the proponent when to begin their remarks, how much time is allotted to them, and what will happen when the allotted time is over.

Ensure that the proponent can clearly hear the chair and be heard by the attendees throughout their remarks. Any pre-recorded or written remarks provided by the proponent in lieu of attendance should be made audible with the same sound quality as the rest of the meeting.

In addition, it is important that shareholder proponents adhere to the rules of order for the meeting and interact with company representatives in a cooperative and constructive manner. As most companies have not conducted many VSMs, proponents should be patient and flexible if legitimate technical issues arise.

▫ *Q&A session.* For many shareholders, a company's annual meeting is the only opportunity they will have to address questions and comments to the company's board and shareholders. Companies should allocate ample time for Q&A based on the number of questions submitted in advance and reasonably anticipated to be received during the meeting.

Explain how much time will be dedicated to the Q&A session and how the company will handle questions it may not be able to get to before time expires Explain in what order the company will recite and

answer the questions submitted and note whether the company will take multiple questions from a single shareholder, and if so, in what order.

Identify each questioner before reciting their question. Recite, as best as possible, each question verbatim as submitted by the shareholder, rewording or paraphrasing the shareholder's submission only when necessary. If answering once for multiple questions on the same topic, indicate that other shareholders submitted similar questions.

Have members of the executive team and board committee chairs, in addition to the board chair or lead director and CEO, in attendance with the ability to audibly answer questions as appropriate. Address all, or substantially, all questions received in advance of the meeting (if the company elects to solicit questions in advance).

Shareholders asking questions should comport themselves with due respect for the meeting and other shareholders wishing to ask questions. In that regard, shareholders posing questions should refrain from disruptive behavior, verbal abuse, and personal attacks unrelated to the company or board members, executives or other employees, or other shareholders Shareholders should keep questions and comments germane to the company and not raise personal grievances.

☐ ***After the meeting.***

Within a reasonable period of time after the meeting, the company should post on its website a recording of the entire meeting, including the Q&A session, for a specified, extended period of time.

In summary, given the likely trend toward increased use of VSMs, the question is whether the benefits of in-person shareholder meetings can be replicated at VSMs, or replaced with something of value to both companies and shareholders. With a much broader reach, the VSM could evolve into an important part of a company's overall engagement efforts, creating an incentive for the company to provide more substantive content on a broader set of subjects of importance to its shareholders.

What Is Next For VSM

Optional And Emerging Practices

Companies should experiment with innovative practices and different types of digital communication to enhance the VSM experience for their shareholders.

☐ Post all VSM instructions and related content (including what can be found in the proxy materials) on the company's website at the same time or promptly after the company files the definitive proxy materials with the SEC.

☐ Post all questions received both before and during the meeting, and corresponding answers, on the company's website within a reasonable period of time after the meeting.

☐ Post a transcript of the full meeting (including Q&A session) on the company's website.

☐ Provide a live video feed of members of management and the board.

☐ Allow shareholders to call in to ask questions and be heard in real time.

☐ Extend the time of the meeting to answer questions submitted.

☐ Provide closed captioning or signing for the hearing impaired.

☐ Provide real-time translations into multiple languages.

☐ Give shareholders the ability to see all appropriate questions submitted in advance and track prioritization of the questions in the queue throughout the meeting.

☐ Give shareholders the ability to indicate their level of interest in particular questions shown in the queue.

☐ Allow shareholder proponents and questioners to appear on video.

As the technology advances, VSM platforms will likely provide more tools for a truly interactive experience for boards, management teams, and shareholders. However, technology alone will not reinvent annual meetings in ways that companies and shareholders find valuable. The value will be realized only if companies are willing to allocate resources to make their VSMs substantive and mutually beneficial experiences. ■

In Review

Recent Notes & Events

Boardroom Composition

Boardroom diversity improves in the U.S., while C-suite diversity still lags.

America's largest companies have taken great strides in increasing diversity on their boards of directors, according to a report by JamesDruryPartners.

The report has been published regularly since 2011. The 2020 edition analyzes 669 boards and 6,358 board directors across America's largest corporations by taking the top 500 companies in revenue and the largest 500 in market capitalization, as well as interviewing 30 of America's most experienced directors regarding the personal attributes most highly correlated with director effectiveness. The report appraises each board by its "business acumen," an objective measure derived from the combined level of business accomplishment of each of the board's directors, in their principal career fields.

"Diversity continues to be an important part of the conversation, and gender diversity in the boardroom now exceeds that of the executive suite," said James Drury III, CEO of JamesDruryPartners. "While this is a promising development, board directors believe strongly that diversity and strength of business acumen must go hand-in-hand, and we will need continued diversity in the C-suite to ensure public companies have the balanced and experienced oversight needed to operate at the highest levels."

According to the 2020 report, 39.1 percent of board seats analyzed in the report are held by members of gender and/or ethnic diversity, including:

- Twenty-eight percent of seats are held by women.
- Sixteen percent of seats are held by directors of ethnic diversity.

The report finds a slight drop in both business acumen and financial expertise. Both of these findings present challenges. The report measures business acumen and director governance capacity by assessing the roles and responsibilities of each member on a 10-point scale and averaging the total score by the number of directors. This year, the average director weight of the 669 companies analyzed was 6.59, down from 6.62 in 2017. Ideally, a board with strong corporate governance capacity should have an average director weight of 7.0 or greater.

Only 43 percent of active Fortune 500 CEOs served on outside boards in comparison to 1990, when 70 percent served on outside boards. While there is no strong reason to have a majority of broad-gauged CEOs on the board, an overreliance on adding directors of more narrowly specialized backgrounds can hinder a board's capability to govern effectively. Such directors often lack the breadth of experience to oversee the company with a holistic approach. As a result, it tends to force the authority and weight of the board into the hands of those more broadly-experienced directors to make informed governance decisions, particularly in times of great crisis.

Another alarming deficiency is found in the limited number (13.5 percent) of board directors having CFO or accounting backgrounds serving on the board audit committee as financial experts. Boards are required by the U.S. Securities and Exchange Commission to have an audit committee of independent directors, with one who qualifies as a financial expert. Only 60 percent of audit committee members qualify as designated financial experts and, of those, only 45 percent have CFO or public accounting experience, representing only 27 percent of the audit committee membership. As the first sign of corporate underperformance vulnerability is often detected within the audit committee, the apparent absence of truly disciplined financial perspective is highly concerning.

Boardroom Practice

U.S. corporate governance gets a B-grade in 2020.

Effective governance is never more important than during a crisis, and COVID-19 has challenged corporate America like never before. Despite (or, perhaps, because of) a pandemic that fundamentally changed how most companies operate, The Institute of Internal Auditors/University of Tennessee's second annual American Corporate Governance Index (ACGI) shows some improvements in governance practices among publicly held companies in the United States.

This year's ACGI finds companies scoring an average B- (82) on a scale of 1 to 100. That is a slight gain from a C+ (79) a year ago. Still, the score falls short of ideal practices for ensuring corporate sustainability, a healthy culture, transparent and accurate disclosures, and effective policies and structures.

Results show gains across the Index's eight Guiding Principles of Corporate Governance. Compared with last year's results, company size (revenue) and industry took on bigger roles in explaining variations in scores. The results suggest that, during periods of heightened risk such as COVID-19, companies in regulated industries (financial services, and transportation and utilities) have stronger governance.

The most notable improvement, according to the Index, is a decrease in the number of companies receiving a failing governance grade. In 2019, 10 percent of companies scored an F, compared with only two percent in 2020. The majority of companies scored in the B and C range of governance performance, with less than one-fifth earning an A-range performance.

"The pandemic-fueled focus on crisis management likely contributed to the modest gains we see in this year's ACGI," said IIA President and CEO Richard F. Chambers. "However, this year's ACGI shows that more than one-third of board members would be hesitant to offer a contrary opinion or to push back against the CEO. What's more, boards do not do an adequate job of verifying—or even asking—whether information they receive is accurate or complete, scoring only a D+."

Among other findings:

☐ *Bureaucracy hampers governance.* Management structures are not always effective at getting the right information to the right decision-makers in a timely manner (Score: C+ or 79).

☐ *Governance demands transparency, but it is not always there.* Companies could be more purposeful and transparent in choosing and describing policies and procedures related to corporate governance to allow key stakeholders an opportunity to evaluate whether these are optimal and reliable (Score: C or 75).

☐ *Long-term outlooks and governance evaluations continue to lag.* Companies continue to be deficient in their long-term outlook (Score: C-, or 70). They do not formally evaluate the full system of corporate governance on a regular basis, leaving the door open to critical gaps (Score: C- or 71). At the same time, employee receive inadequate training to complete expected job duties (Score: C or 76).

Disclosure

Human capital management disclosure is here to stay.

The events of 2020 have intensified the need for boards and senior management to focus on their firms' workforces. Boards face a daunting challenge, however: to focus on the human capital management (HCM) issues that are truly key for sustained success. A report from The Conference Board, *Brave New World: Creating Long-Term Value Through Human Capital Management and Disclosure,* provides comprehensive guidance to executives and other practitioners as companies leverage HCM to drive long-term value.

This report's insights and findings were generated through a series of meetings with more than 100 executives, as well as outside experts from private and public corporations.

New Securities and Exchange Commission (SEC) rules broaden the information companies are expected to disclose regarding human capital in their annual financial reports. Even though companies are moving quickly to meet these new disclosure requirements, the focus on HCM will continue to unfold over time. Companies not only need a clear HCM strategy, but also enhanced governance practices and information to move from the workforce they have now to the one they need to achieve future business success.

Insights and recommendations from this report include:

☐ Boards and management should devote sustained time and attention to HCM, and be prepared for their strategy, practices, and disclosures to evolve over time.

☐ Boards should evaluate their firm's current human capital capabilities and future needs, considering the adoption of a human capital strategy that supports the company's broader business strategy.

☐ Companies should customize their HCM disclosures to reflect their business and human capital strategies, with reporting frameworks and regulations as a starting point for their discussion.

☐ It will be important for companies to have a robust process for updating their disclosures as their understanding of HCM evolves, board practices mature, and industry practices and investor expectations change over time.

☐ Boards have an increasingly important role to play in human capital management and disclosure. They can shape the workforce in multiple ways: hiring, firing, promoting, and paying executives; approving human resources and compliance policies; and exercising their oversight powers. Each company will not only need to clarify and codify the roles of its board and its committees with respect to HCM, but also ensure that boards exercise their multiple powers in a coordinated manner.

☐ Boards should have an in-depth, candid understanding of the corporate culture and its role in the overall HCM strategy. To provide context and accountability, companies should use both quantitative and qualitative measures for evaluating HCM performance.

☐ Companies should ensure boards have, or have access to, HCM expertise.

"Workforce issues have often been an episodic priority for boards, particularly after mergers, scandals such as #MeToo, or during the current pandemic," said a spokesman for The Conference Board ESG Center. "The workforce now needs to be a sustained strategic priority for corporate directors. That requires taking a fresh look at the board's governance practices, the information it receives, the disclosures the company makes, and how the board can leverage its multiple powers to help drive the company's workforce strategy."

While companies are moving quickly to increase their HCM disclosures in their Annual Reports on Form 10-K, the new SEC rules are not the only compelling driver.

Intangible assets such as workforce capabilities are an increasingly large part of a company's market value, and research establishes a clear connection between strong HCM practices (and good HCM disclosure) with shareholder value.

HCM matters to many other constituents, including investors who see HCM issues as essential to sustainable long-term value creation, as well as employees, consumers, and the public.

Liability & Litigations

Securities-related settlements exceeded $5.8 billion in 2020.

In the midst of a global pandemic, securities class action cases continue to provide investors with critical recoveries from companies accused of various fraudulent activities. In fact, the dollar amount of settlements in 2020 totaled $5.84 billion, an increase of 61 percent over the $3.62 billion in settlements during 2019.

An ISS memorandum notes that the number of worldwide settlements in 2020 where a monetary amount was agreed to totaled 133. This was an increase of 13 percent above the 118 settlements finalized during 2019.

The primary difference between 2019 and 2020 were with the mega settlements, typically considered cases set-

tling for $100 million or greater. While the quantity of these cases were similar during the last two calendar years, the largest settlements in 2020 were incredibly higher in dollar amounts. The two largest settlements in 2019 were Cobalt International Energy at $389.6 million and Alibaba Group Holding at $250 million, while the top 2020 settlements were:

☐ Valeant Pharmaceuticals: $1.210 billion.

☐ American Realty Capital: $1.025 billion.

☐ First Solar: $350 million.

☐ Signet Jewelers: $240 million.

☐ SCANA Corp.: $192.5 million.

Interestingly, 2020 was the first year since 2016 with two settlements worth more than one billion dollars (in 2016, Household International settled at $1.575 billion and Merck settled at $1.062 billion).

Of the 117 U.S.-based settlements in 2020, six were S&P 500 listed companies. This includes the $149 million Equifax settlement, which ended litigation related to the high-profile data breach.

Not surprisingly, the Federal court with the most 2020 activity was the USDC New York (Southern) with 29 settlements. The next highest quantity at seven cases included both the USDC New York (Eastern) and USDC New Jersey. At the State level, the most frequent venue was the Delaware Chancery Court with nine settlements. The next highest quantity at two cases involved both the Nevada District Court, Clark County and New York Supreme Court, New York County.

Mergers & Acquisitions

M&A valuations boomed in the second half of 2020.

Merger and acquisition valuations are soaring, with rich valuations and intense competition for many digital or technology-based assets driving global deals activity, according to PwC's Global M&A Industry Trends analysis.

Covering the last six months of 2020, the analysis examines global deals activity and incorporates insights from PwC's deals industry specialists to identify the key trends driving M&A activity, and anticipated investment hotspots in 2021.

In spite of the uncertainty created by COVID-19, the second half of 2020 saw a surge in M&A activity.

Says a PWC spokesman, "COVID-19 gave companies a rare glimpse into their future, and many did not like what they saw. An acceleration of digitalization and transformation of their businesses instantly became a top priority, with M&A the fastest way to make that happen."

Insights from the second half of 2020 deals activity include:

☐ Dealmaking jumped in the second half of the year, with total global deal volumes and values increasing by 18 percent and 94 percent, respectively compared to the first half of the year. In addition, both deal volumes and deal values were up compared to the last six months of 2019.

☐ The higher deal values in the second half of 2020 were partly due to an increase in megadeals ($5 billion+). Overall, 56 megadeals were announced in the second half of 2020, compared to 27 in the first half of the year.

☐ The technology and telecom subsectors saw the highest growth in deal volumes and values in the second half of 2020, with technology deal volumes up 34 percent and values up 118 percent. Telecom deal volumes were up 15 percent and values significantly up by almost 300 percent due to three telecom megadeals.

☐ On a regional basis, deal volumes increased by 20 percent in the Americas, 17 percent in EMEA and 17 percent in Asia Pacific between the first and second half of 2020. The Americas saw the biggest growth in deal values of over 200 percent, primarily due to some significant megadeals in the second half of the year.

In demand assets have commanded high valuations and fierce competition, driven by macroeconomic factors. These include low interest rates, a desire to acquire innovative, digital or technology-enabled businesses, and an abundance of available capital from both corporate (over $7.6 trillion in cash and marketable securities) and private equity buyers ($1.7 trillion).

By comparison, assets in sectors that have been hardest hit by the pandemic (like industrial manufacturing or those transforming to net-zero carbon emissions) are creating structural changes that companies will need to address. Where the future viability of their business models are challenged, companies may look to distressed M&A opportunities or restructuring to preserve value.

Non-traditional sources of value creation, such as the impact of environmental, social and governance factors (ESG), are increasingly being considered by deal makers and factored into strategic decision-making and due diligence, as they focus on protecting and maximizing returns from high valuations and fierce demand.

The last six months saw the prevalence of the use of special-purpose acquisition companies (SPACs) to pool investor capital for acquisition opportunities in a highly active IPO market. In 2020, SPACs raised about $70 billion in capital and accounted for more than half of all U.S. IPOs. Private equity firms have been key players in the recent SPAC boom, finding them a useful alternative source of capital. More SPAC activity is expected in 2021, especially involving assets such as electric vehicle charging infrastructure, power storage, and healthcare technology.

Strategy & Finance

Fourth quarter 2020 showed surprising strength for IPOs.

Despite the uncertainty of 2020, IPO investors enjoyed a prosperous year as IPO activity proved resilient to the impact of the COVID-19 pandemic, supported by low interest rates and expansionary monetary policies. Global IPO volumes continued to accelerate, increasing by 19 percent to 1,363, while proceeds increased 29 percent year-on-year to a total of $268 billion. This strong IPO performance indicates global

equity markets continue to provide the platform for companies with access to public capital.

The Americas saw the biggest year-on-year increase in both IPO volumes and proceeds, with 2020 IPO numbers increasing 30 percent to 282, and proceeds rising 78 percent to $97.9 billion. Asia-Pacific also made significant gains, recording a 20 percent increase in IPO volumes to 822 IPOs and 45 percent in proceeds to U.S. $136.2 billion. In EMEIA, while IPO numbers rose 7 percent to 259 IPOs, proceeds fell 43 percent to U.S. $33.9 billion. Overall, 2020 saw a steady increase in cross-border IPO volume, accounting for 7.9 percent of global IPOs and 10 percent in proceeds, compared with 8 percent and 7.1 percent in 2019 respectively.

The technology sector maintained its lead by both volume and proceeds, finishing the year with 324 IPOs and U.S. $89.1 billion respectively. Industrials followed in second place with 243 IPOs and U.S. $31.4 billion, and then health care with 235 IPOs and U.S. $50.4 billion in proceeds. These and other findings were published in the EY quarterly report, *EY Global IPO Trends: Q4 2020.*

An EY spokesman observed: "2020 was full of surprises. Market volatility in the first half of the year was higher than any time since the global financial crisis. But volatility quickly subsided, with the year ending on the back of some stellar IPO market performances. Buoyant global IPO markets have demonstrated the resilience of equity markets despite the pandemic. Capital markets and IPOs allow high-growth companies to fund innovation, accelerate growth and make significant contributions to society.

"Looking to the first half of 2021, continued fiscal stimulus, abundance of liquidity and optimism linked to COVID-19 vaccines should sustain IPO momentum. However, investors should beware of any potential market correction, especially for those companies that have seen their share prices make substantial gains from the market rally in 2020."

Retrospectives

20 years ago in *The Corporate Board.*

In some respects, a renewed commitment to the highest corporate governance practices may require a cultural shift in the way all market participants think about their duties. It is not enough to have rules and guidelines securely in place and then ignore their practical application, or even greater, the public spirit that brings them to life. All directors must embrace this as our own collective mandate. It is a call that will continue to make America's companies and its markets an enduring beacon of what vigilance and integrity can cultivate.

— Arthur Levitt,
Rising to the New Governance Standards,
March/April 2001

10 years ago in *The Corporate Board.*

Board chairs face one over-riding dilemma: *achieving the board's full potential vs. maintaining steady progress.* Push hard for all the marbles and you risk collapse, revolt or at the least, loss of key members. Settle for a maintenance agenda and risk creating a board that adds no real value and is incapable of helping if things turn south.

— Alex Lowy,
The Seven M's of Board Leadership,
March/April 2011

Books Received

Startup Myths and Models. By Rizwan Virk. Columbia Business School Publishing. $27.95. Collecting wisdom and examples from noted venture capitalists and entrepreneurs, the author sorts through (and demolishes) many of the most enduring misconceptions on how startups succeed and fail.

Spoken & Written

Articles & Speeches

In all candor, [working remotely] is not like being together physically. And so I can't wait for everybody to be able to come back into the office. I don't believe that we'll return to the way we were because we've found that there are some things that actually work really well virtually.

— Tim Cook,
Apple Inc.

Principles guide good managers when making decisions. Yet these principles do not come from external norms of "ethical custom," especially not if the custom derives from the progressive beliefs of the moment. Principles, if they are to be effective in guiding any organization, must be grounded in faith or at least in some other lasting, existential commitment. They can be reinforced by a healthy corporate culture, but there is no substituting for internally grounded habits such as honesty, trustworthiness, and self-discipline. We used to call that virtue.

— Andrew V. Abela,
Catholic University of America

If there are multiple diverse candidates, they're multiple times more likely to be hired. Why is that? When you have isolated, coveted jobs, you need to do something to change the norms because the presumptions and stereotypes are so deeply rooted. It's not telling people who to hire, it's about picking the best person.

— Cyrus Mehri,
Mehri & Skalet PLLC

Generally, my recommendation would really be spend less time on finance, spend less time in conference rooms, less time on PowerPoint, and more time just trying to make your product as amazing as possible. And the company might take their cue from that.

— Elon Musk,
Tesla, Inc. and SpaceX

Retailers will create communities around their brands that become points of gathering. We will shop together virtually and share tidbits in all ways we communicate. Shopping will be fun and we will aspire to be a part of retail movements and moments.

— Matt Rubel,
MidOcean Partners

Nasdaq is required by the SEC to protect investors and promote the public interest. While capitalism has shown that it can improve the lives of billions, trust and support for the markets will only be maintained if its workings and results are shared by all of society.

— Nelson Griggs,
Nasdaq Stock Exchange

In a country where the average 50-year-old has already worked for 12 different employers, the idea that we should move our family permanently from Silicon Valley to Iowa on the promise that our current job with a big tech company will continue indefinitely is foolish.

— Dr. Peter Cappelli,
Wharton School

Software changed the world the consumer lives in; now it's changing the world that manufacturers live in. And while there are few silver linings in a pandemic, the rate of positive change for American manufacturers has been accelerated for the better.

— Scott Davis,
Melius Research LLC

It is crystal clear to companies that have been around a long time that it is in our selfish and pecuniary interests to be good community citizens. Because it's good for our brand. It's good for motivating our people. It's good for creating economic opportunity, which also enhances our customers and causes them to be that much more loyal to us.

— Arne Sorenson,
Marriott International Inc.

The most powerful argument for board diversity is that diversity is a social good. The most powerful argument against a board diversity requirement is that if it were manifestly good for companies, there would be no need for it in the first place. Successful companies can't keep secrets quiet for long; if one could reliably increase its market capitalization by, say, five percent through the appointment of a diverse board, every company on NASDAQ would already meet that standard.

— Arthur Levitt Jr.,
Former chair, U.S. Securities and Exchange Commission

Maintaining U.S. financial preeminence should be a priority for the Biden administration. Traditionally, challenges to American leadership have come from well-established financial centers like London, Hong Kong and Tokyo. But mainland China will be an increasingly formidable challenger in financial services in the next few years.

— Henry M. Paulson, Jr.,
The Paulson Institute

Nature developed its stabilizing, self-correcting features over billions of years. Humanity can't afford that kind of time. But governments and businesses can learn from nature's strategies, building institutions and networks that balance efficiency with redundancy and resilience. In stable times this may seem inefficient or superfluous, but the investment pays off when unexpected shocks hit, as they inevitably will.

— Dr. Ruth DeFries,
Columbia University

Cybersecurity is advancing year after year, so even if they manage to create a new type of protection or evolve in some way, bad hackers will always be running the race and they will be discovering and preparing different new ways to make companies vulnerable.

— Santiago Lopez,
HackerOne

Directors' Register

Recent Board Elections

3M Company has elected to its board ***Jim Fitterling,*** chairman and chief executive officer of Dow, Inc.

Alaska Air Group has elected to its board ***Daniel Elwell,*** former deputy and acting administrator of the Federal Aviation Administration.

Asbury Automotive Group, Inc. has elected to its board ***William D. Fay,*** former senior vice president of automotive operations for Toyota North America.

The Boeing Company has elected to its board ***Lynne Doughtie,*** former U.S. chairman and chief executive officer of KPMG.

Cigna Corporation has elected to its board ***George Kurian,*** chief executive officer of NetApp, Inc.

Deckers Brands has elected to its board ***Maha S. Ibrahim,*** a general partner of Canaan Partners.

Delek US Holdings, Inc. has elected to its board ***Laurie Z. Tolson,*** chief executive officer of Tolson Consulting Company and former chief digital officer of GE Transportation.

Dover Corporation has elected to its board ***Deborah L. DeHaas,*** chief executive officer of the Corporate Leadership Center.

Eastman Chemical Company has elected to its board ***Vanessa L. Allen Sutherland,*** executive vice president and chief legal officer of Norfolk Southern Corporation.

Eli Lilly and Company has elected to its board ***Kimberly H. Johnson,*** executive vice president and chief operating officer of the Federal National Mortgage Association ("Fannie Mae").

Genuine Parts Company has elected to its board ***Juliette W. Pryor,*** general counsel and corporate secretary of Albertsons Companies.

Graphic Packaging Holding Company has elected to its board ***Mary K. Rhinehart,*** chairman and former president and chief executive officer of Johns Manville.

International Paper Company has elected to its board ***Anton V. Vincent,*** president of Mars Wrigley North America.

Kohl's Corporation has elected to its board ***Robbin Mitchell,*** a partner and managing director at the Boston Consulting Group.

The Kroger Co. has elected to its board ***Kevin Brown,*** executive vice president of global operations and chief supply chain officer for Dell Technologies, and ***Amanda Sourry,*** former president of North America for Unilever.

Lawson Products, Inc. has elected to its board ***Bianca Martinez Rhodes,*** president and chief executive officer of Knight Aerospace Medical Systems, LLC.

Marathon Oil Corporation has elected to its board ***Brent Smolik,*** former president and chief operating officer of Noble Energy Corporation.

Merck & Co., Inc. has elected to its board ***Dr. Stephen L. Mayo,*** the Bren Professor of Biology and Chemistry at the California Institute of Technology.

Myers Industries, Inc. has elected to its board ***Yvette Dapremont Bright,*** president of Brighter Horizon Foundation, and ***Dr. Jeffrey Kramer,*** chief executive officer of Schweitzer-Mauduit International.

NextEra Energy, Inc. has elected to its board ***Lynn M. Utter,*** former chief talent officer of Atlas Holdings LLC.

Oceaneering International, Inc. has elected to its board ***Karen H. Beachy,*** former senior vice president of growth and strategy at Black Hills Corporation, and ***Dr. Kavitha Velusamy,*** vice president of software engineering for Leia, Inc.

PriceSmart, Inc. has elected to its board ***Patricia Márquez,*** associate provost for academic planning and innovation and dean of the Joan B. Kroc School of Peace Studies at the University of San Diego, and ***David Snyder,*** senior counsel at Pillsbury Winthrop Shaw Pittman, LLP.

The Shyft Group, Inc. has elected to its board ***Terri Pizzuto,*** former executive vice president, chief financial officer and treasurer of Hub Group, Inc., and ***Mark Rourke,*** president and chief executive officer of Schneider National, Inc.

SkyWest, Inc. has elected to its board ***Smita Conjeevaram,*** former deputy chief financial officer of Fortress Investment Group's Credit Funds.

SPX FLOW, Inc. has elected to its board ***Sonya McCullum Roberts,*** president and group leader for the salt business at Cargill Incorporated.

Stepan Company has elected to its board ***Lorinda Burgess,*** vice president, finance and chief financial officer of the Americas region of Medtronic Inc.

The Timken Company has elected to its board ***Sarah Lauber,*** chief financial officer and secretary of Douglas Dynamics.

Tractor Supply Company has elected to its board ***Joy Brown,*** chief data officer for Verizon Media Group and former vice president of card technology for Capital One.

Conversations

Jeff Immelt: Re-telling The General Electric Story

For Jeff Immelt, succeeding legendary General Electric CEO Jack Welch in 2001 in a time of sweeping business and technology change was quite a challenge. The 9/11 attacks on the World Trade Center the next day was a hint that Immelt's tenure would not be easy. He has just released a new book ***Hot Seat*** *[Avid Reader Press/Simon & Schuster] telling his side of his tenure at GE.*

The Corporate Board: Former CEOs of major corporations often write books. What makes yours different?
Jeff Immelt: I wrote the book for two reasons. One, I felt that a lot has been written about GE in the last few years, and I wanted to provide a fuller context on things I thought were missing. It was a complicated story.

Also, all leadership today is crisis leadership. I believed I had a particularly unique perspective on that after all the crises we lived through at GE. I though some of my lessons could be beneficial.

TCB: How has the CEO's role changed over the years?
Immelt: I held the role from 2001 to 2017, and the task became much more complicated and difficult. If you go back in time, every CEO has been responsible for basics like strategy and people. But there is a lot more risk involved now, and more intersection with government.

Globally, it's also more complicated. When I took over at GE, 70 percent of our market was in the U.S. When I left, 70 percent was global. There is more investor and social activism, with lots of active engagement. It's incumbent on companies now to become simpler if they can, just to make them more manageable.

TCB: What is your take on The Business Roundtable's 2019 statement urging companies to give more thought to stakeholders?
Immelt: At a high level, the Roundtable statement makes sense, and is appropriate. The role of governance around us is very critical now, and business can't be separate from that. The challenge to me is that *shareholders* have the ownership, and have very different perspectives. That can pull them in different directions from the company and *stakeholders*.

TCB: Was that an issue with GE's stock price decline during your tenure?
Immelt: There can be discrepancies between a company's performance and its stock price at any time. We had some strong market positives, and lots of valuable initiatives underway. We were quite strong compared to our peers, but yes, the stock still underperformed. That's not an excuse.

There are times when you get a disconnect on the market value versus how you're actually doing. At GE, we had a financial services business that was very highly valued in the '90s, but after the 2001 crisis, it was valued at a fraction of its earlier worth, so I knew we'd be flying into long-term headwinds.

TCB: When you don't believe the market fairly values the company, how do you respond?
Immelt: The day Lehman Brothers went bankrupt [in 2008], I knew it would be a long time before the financial services of GE would be as valuable as before. All we could do is try to motivate the company through communications, maybe even force of will. You have to hold onto two thoughts. First, there are many pieces to our company where things are going positive, so you have to tell that story. You have to remind everyone of the company's purpose, and persevere. The other thought to hold onto is that the CEO must absorb everyone else's fear. You can't just say "oh no, this is terrible". Let your people know why they matter.

TCB: The CEO succession horse race at GE in 2001 was one of the most public leadership contests in history. What lessons have you learned?
Immelt: The era is different now. If you look at 2000 versus 2021, the way people look at companies, celebrity CEOs, and the shareholder process are all very different. You now have to look at succession as candidly as possible, and be much more transparent. When you go through CEO transition, the board has to own the process. The old CEO will be disappearing quickly, so the new leader has to stand on his feet immediately.

TCB: How did GE's corporate governance evolve over your tenure?
Immelt: We were having board members visit our businesses, have access to consultants, and talk without company leadership present—so most good governance items were in place. I never felt the role of the board was to support me, but I did expect them to defend their own decisions. Once we jointly made a decision, they had to be part of making it work.

When GE Capital was regulated by the Fed [after the 2001 crisis], we had 18 board members instead of just 12, for a time. They were more diverse and global. That brought more investor outreach and board engagement. It brought even more transparency and outside scrutiny, but that was part of what worked for us during that period.

TCB: How does a board really help a CEO to be effective?
Immelt: I think a good board can help you think through strategy. When we sold NBC, the board was good at thinking through risk items and people leadership. Board members bring access to outside leaders and help you build connections.

One thing people don't write about enough is how important your board is in a crisis. Don't look at your board makeup for how it works in normal times. Envision how it will work when it's your very worst day. Look around the board table. Who is a helper, who's not? Who will panic, who will stay calm?

I needed a board that could be extremely active and helpful in tough times. Every company is going to have a really bad day sometime. ■

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Anyone can hold the helm when the sea is calm.

— Publilius Syrus