We Have Met the Enemy...and They is Us | Directorship | Boardroom Intelligence

When 290 corporate directors were recently asked, “what is the biggest problem with corporate governance in the US,” two answers tied for highest response at 59 percent: predictably, “too much focus on short-term results,” and surprisingly, “lack of understanding about what corporate boards do.”

In another survey sponsored by *Directorship*, major disconnects were found among executives, directors, and other constituencies. For example, on the often-discussed proposal to split the chair and CEO roles, directors didn’t think it was much of an issue, yet a staggering 90 percent of the other respondents thought it was. Directors also felt that they worked longer hours and were more effective than their own CEOs gave them credit for.

> Editor’s Note: The Director’s Chair is a new column to provide readers perspectives from inside the boardroom. We welcome submissions from public company board directors and officers.

Clearly, directors see a problem in public, and executive, perception about what they really do, and they continue to look outside the boardroom for the cause. But the answer may lie within. As the comic strip character Pogo often said, “we have met the enemy and they is us.” As directors of public companies, many of us have indeed become our own worst enemy by insulating ourselves from Main Street, and C-suite, engagement. Here are five strategies for boards to consider in improving how they are perceived outside the boardroom.

1. Welcome a say on pay

“Say on pay”—granting shareowners a greater voice in setting executive pay—continues to be a hot issue with investors. Legislation is moving through Congress that would give the Securities and Exchange Commission (SEC) the authority to require nonbinding annual say-on-pay votes for all public companies. Proponents maintain that say on pay will improve board accountability and give shareowners a way to express their views on executive compensation. Opponents say shareowner involvement would make it harder to recruit top executives.

Although some companies have voluntarily adopted the say-on-pay concept, most notably, Microsoft and insurance giant Aflac, many boards continue to resist. They see themselves as immune from shareholder opinion, maintaining that shareholders have elected them to make these pay decisions.

Whether say on pay is ultimately required or remains voluntary, boards can build trust with shareowners through a willingness to address the issue proactively.

2. Be open to shareowner dialogue

In communicating with shareowners, boards have typically played it safe. The tendency to stay mum is fueled by the SEC’s Regulation Fair Disclosure, or “Reg FD.” The concern is that directors may disclose information to a select group of shareowners rather than the market as a whole. Yet some boards have succeeded in responding to shareholders’ views while abiding by legal constraints. These boards have typically sought in-house or outside counsel to provide legal advice on appropriate shareowner communications.

Engaging in dialogue with shareowners can yield a host of benefits, from building investor trust and confidence to better understanding their interest in the company’s long-term objectives. Opportunities for dialogue can range from answering board questions at annual meetings, to meeting with shareholders at open-invitation or invitation-only specially scheduled meetings, to opening the doors for shareowners to communicate with board members at any time. As a first step, consider focused meetings with the board’s nonexecutive chair, lead director, or committee chairs, following a set agenda and using a “listen-only” mode for directors.

Regardless of the venue or timing, successful communication requires suspending any suspicion of shareholder motives and cultivating a mindset of appreciation as opposed to confrontation.

3. Conduct effective self-evaluations

Giving board members the opportunity to rate their job performance is integral to best governance practices. It can reaffirm board member contributions and illuminate areas where each director, and the board as a whole, can improve.

Although the New York Stock Exchange requires boards to conduct an annual self-evaluation, not much guidance has

been given on specific approaches. Typical evaluation tools range from written surveys to 1-to-5 ratings, open-ended questions to interviews with the board chair. One of the most effective methods widely used in management evaluations, the 360 review, has been met with the most resistance by boards. These reviews—enabling directors to rate each other—can be difficult because board members view their relationships as collegial and don't want to be perceived as being critical.

For boards intent on demonstrating to shareowners the quest for optimum performance, use of the 360 review can present a strong case. Along with individual reviews, effective boards are also evaluating the board's performance overall, comparing outcomes against set goals and published best governance practices.

4. Reconsider the staggered board

Some boards continue to pursue the "staggered board" model, where boards are made up of different classes of directors—each serving a different term length than the other, for example, two-, three-, and five-year terms.

Staggered boards are perceived to be a problem in the eyes of many shareowners. Although some argue that varied terms provide continuity and discourage hostile acquirers from gaining control and replacing an entire board, the predominant public view is that staggered boards are less accountable to shareholders than annually elected boards. Varied terms are thought to create a fraternal boardroom atmosphere that serves to protect the interests of management over those of shareholders. On the other hand, annual terms are seen as a means of providing optimum opportunity to adjust board composition and ensure that all board members are pulling their weight.

Congress is considering requiring companies that choose staggered boards to disclose their rationale. Those with staggered boards may have good reasons for their choice but will likely need to delineate special circumstances in their governance principles. Where staggered boards are in place, consider strong and open communications with influential shareowners, emphasizing director independence and strengthening the board self-evaluation process to identify and correct those directors who may have "retired in place" or are otherwise disruptive to the board's effectiveness.

5. Split the roles of board chair and CEO

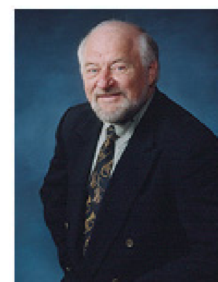
Although Congress recently decided against requiring companies to split the chair and CEO roles, shareowner opinion continues to weigh toward role splitting. Advocates maintain that split roles are better business, enabling the CEO to run the company with minimum distraction while the board chair directs board business. Split roles can also be a way to assure shareowners of truly independent leadership.

New SEC regulations will require companies that maintain a joint CEO/chair role to justify why the roles weren't split. Boards that have not split the roles should begin the discussion now on how this question will be addressed with the next CEO.

Bridging the gap

Turbulent economic times, a hands-on administration, and increasingly vocal shareowners will continue to thrust board members into the public spotlight. As our governance roles are illuminated, the disparity between how we are perceived and how we see ourselves is real—and growing. The job is ours to bridge the gap, shaping public opinion before it is shaped for us.

Think about embracing these strategies for change rather than resisting them. Don't wait for a scandal over executive pay or risk management to motivate interaction with shareowners. Consider ways to be more open, more constructive, and less secretive. Talk it over in the boardroom. Then decide what's right for your company and shareowners.



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