Giving Boards Their Voi

Nigel Buchanan

The chief communications officer of a Fortune 50 company was quick to say, 'No thank you,' when an independent communications advisor offered assistance to the company's board and the lead director.

"You raise some important challenges in your memo, without question," the communications officer said in her e-mail response to the consultant. "We believe our staff, particularly our general counsel, already works closely and well with our board to ensure we exercise best practices in corporate governance. And when there are specific media and communications opportunities, I would be engaged as well. So, at this time, I don't see a need."

The communications officer might have been wiser to give the overture a second thought. In this period of intense board scrutiny, when boards must assert their independence and authority, getting outside help may have a value far greater than this executive realized. It no longer is enough for boards to refrain from communicating or to communicate only through the legally required Proxy, 10 K and 8 K documents. They must do more to show they are representing owners and holding management accountable.

Operating Behind the Scenes

Many board members believe that it is entirely appropriate for them to funnel their communications through management and are puzzled by suggestions that they are incommunicative. Some still operate as members of old boy's networks and do not believe they answer to anyone.

"I cannot see any reason for the board to ever communicate. The board's job is to ensure that management is communicating," said one bank chairman who sits on three Fortune 100 boards and requested anonymity. "We ce

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aren't seeking publicity."

To other board members, the 8K, the 10K, the proxy and other governance documents that boards routinely file provide more than ample transparency.

Still others see perils in independent communications. Some, for example, are concerned that by speaking independently, they will inadvertently run afoul of selective disclosure regulations that prohibit providing information to some members of the public, but not others.

"Many directors are reluctant to engage shareholders out of concern for Regulation FD and their ability to insure that the conversation does not cross the line." said Bonnie Hill, lead director of Home Depot. She agrees that having a board-shareholder communication policy and media training are key ways to successful interations. Defining the context and scope of the dialogue with shareholders is also important." She added, "I have never had a shareholder group ask something that was inappropriate. They are aware of Regulation FD. I think it's important to listen and sometimes agree to disagree. We have learned so much talking to shareholder. It's made us better directors."

Some directors see dangers in boards being more open and consequently giving shareholders greater voice in board-related decisions. One former corporate executive and now director of several boards, who requested anonymity, expressed concern over shareholder nomination of board members. Over the past several years, he said he has seen "random" suggestions from shareholders for board nominees that reflected the concerns of "painters and poets."

Forces for Change

Despite widespread resistance though, forces are coalescing to compel boards towards greater independence and openness in their communications. In large part, shareholder discontent, intensified by the recent financial crisis, has spurred government to press the issue.

A sense of voicelessness and helplessness has fueled the shareholder activism by major institutional investors during the past 15 years, according to Stephen M. Davis,executive director and lecturer at the Millstein Center for Corporate Governance and Performance at the Yale School of Management. These shareholders believe they lack access — to the directors and to information. This "under-representation" feeds some activists' demands to be recognized as owners, whether in advocating for say-on-pay, majority voting or even in battling for board seats.

"The subject of board-shareholder communication, in terms of importance, is right up there with CEO compensation and CEO succession execution, which are being handled poorly and criticized severely," says Fred G. Steingraber, chairman and CEO Emeritus of A.T. Kearney and a director for 3i PLC in the United Kingdom and other boards. "Shareholder communication is an area where boards are too defensive and all too often reacting to events rather than proactively leading with more transparent and timely communication," said Steingraber. He has observed that in the past 10-15 years, boards have changed from being largely led or driven by CEOs, to directors taking more control. Following the corporate scandals in the early '90's, shareholders gained influence with victories on say-on-pay and majority voting "Today, the government is taking control of boards, largely due to directors not building good relations with shareholders and all too frequently being too defensive and too reactive in their communication," he said.

Pension funds see boards becoming more amenable to change. "Yes, we feel the need to remind them that they represent us as shareholders," said Anne Sheehan, Director Corporate Governance of the California State Teachers Retirement System, "CalSTRS", the second largest pension fund in the U.S. "Board members forget that. Yes, they may be nominated through an internal process but they need the shareholders' votes in annual elections to keep their jobs."

SEC Chairman Mary Schapiro sees proxy access rules, which would facilitate shareholders nominating board candidates, as the way to give shareholders a greater say in choosing directors and a practical means of ousting boards. The SEC postponed proxy access changes for the 2010 proxy season but has changed the rules now prohibiting brokers from voting on behalf of shareholders. Those new broker rules take effect in January 2010, will also have an impact on board elections.

"I think this will get individual director's attention, especially if he or she is targeted by a no-vote campaign," said Sheehan, referring to what are known as broker voting rules. "When it becomes personalized, it helps directors to understand the importance of reaching out and communicating."

"Many directors began their board careers when directors were neither seen nor heard and it will take time for them to become accustomed to a more public role," said Rich Koppes, former deputy executive officer and general counsel for CalPERS. This shift — from behind-the-scenes advisors to highly accountable public figures — is a profound transformation that boards are only beginning to grasp.

Newer, younger directors and those who have served on boards of European companies are also providing momentum for change.

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A Lesson in Board-Shareholder Interactions

By establishing independent communications, boards and their companies may succeed in quieting dissenting shareholders and staving off government intervention. But, it may also win them the confidence of shareholders, enabling their companies to operate more in the interests of the long term. In addition, boards may put themselves in the position of being able to make a major contribution to risk mitigation.

Schering-Plough provides a good illustration of what could be gained. In 2003, (CalPERS), the largest public pension fund in the United States, was threatening to put Schering-Plough on its focus list, which meant identifying the company as troubled Breaking with traditional corporate practices, Fred Hassan, Schering-Plough's Chairman and chief executive, along with the chair of the compensation committee and the company's first chief governance officer, met with CalPERS to request time to let the new leadership execute its strategy to repair the company and establish a high-performance culture that could sustain long-term growth

"Since then, we've enjoyed a very good relationship with CalPERS," said Susan Wolf, the chief governance officer. As part of a new shareholder engagement program, Schering-Plough also met with a range of shareholders, discussing their views on a range of issues, says Wolf.

" As a result, we have enjoyed very strong votes in favor of management's proposals, very few withhold votes on directors and largely we've avoided the adversarial situations that many of our peer companies face," says Wolf.

"If boards handle it right, they can win the long-term loyalty of their investors," says Davis, of the Millstein Center at Yale. "If they establish solid relationships with long-term owners — typically investors with longer time horizons — boards have more freedom to plan for the long-term."

At least some shareholders see it the same way.

"We want to use our interaction with the board to understand the guidance the board is giving to management," says Sheehan, "It demystifies the process, which enables us to better support long-term objectives of the company."

More communicative boards may also be able to preserve control over their risk mitigation practices. While risk oversight remains a board's responsibility, various shareholder rights bills seek to be more prescriptive about how a board handles risk including the formation of a separate risk committee. Many boards resist such a one-size-fits-all approach. By better communicating how the board is handling risk oversight, boards may be able to stave off regulatory changes and let the board continue to decide what kind of risk program works best for the company

Since boards play a critical role in setting the tone of the organization, the board's greatest impact could be in creating a risk management culture, says Ira M. Millstein senior partner at the law firm Weil, Gotshal & Manges.. One study suggests that operational risk can only be fully addressed if it is communicated throughout the organization, with each employee understanding his impact on risk taking, his responsibility for acting within acceptable limits and his ultimate accountability. To achieve that, directors may need greater involvement with employees. They could accomplish this in part by attending the occasional town hall meeting and showing up at an investor conference. And they should do more than simply be introduced. Allowing the chairs of the key committees to make brief reports and answer questions for employees at large would go a long way towards opening channels of communication

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Developing a Board Communications Plan

For boards that decide that communicating independently is in the best interests of the companies and shareholders they serve, there is no single formula for them to follow. But, there are some common principles they should consider in designing a plan.

Most importantly, they should commit themselves to meaningful communication. Activist investors will react badly to weak attempts at dialogue, lip service or an avalanche of information calculated to placate stakeholders without truly communicating with them.

It is also important for boards to understand that communication is not a one-way street, according to Davis. True communication means listening respectfully and responding appropriately as well as informing and persuading, he says. The purpose of communication must be to genuinely weigh the perspectives of others in decision making.

Wolf attributed much of the success of the revamped communications strategy for Schering-Plough's board in its commitment to regular rather than episodic communication during proxy season or when an investor raised an issue with investors. Shareholders knew when the company implemented one of their suggestions and received an explanation when the final decision departed from their recommendations. Home Depot called "CalSTRS" as it was working on the board's succession plans and asked the pension fund what kind of candidates and skill sets it should consider, says Sheehan.

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Besides through shareholder meetings, town halls and other in-person contact, boards can take advantage of social media to communicate with their stakeholders. Directors should be monitoring the "chatter" in the blogosphere about their corporations and sometimes judiciously joining those conversations.

To ensure that a board speaks with one voice, it will probably want to establish some rules of the road. Those rules would include how it will designate a spokesperson in any given situation; how the spokesperson's message will be determined; how directors will respond if they receive calls from shareholders at home; and other issues.

Whatever the strategy, the sooner directors see the opportunity and begin to take steps to craft independent communication policies, the more likely directors will become a force for restoring trust and optimal performance in their institutions.

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