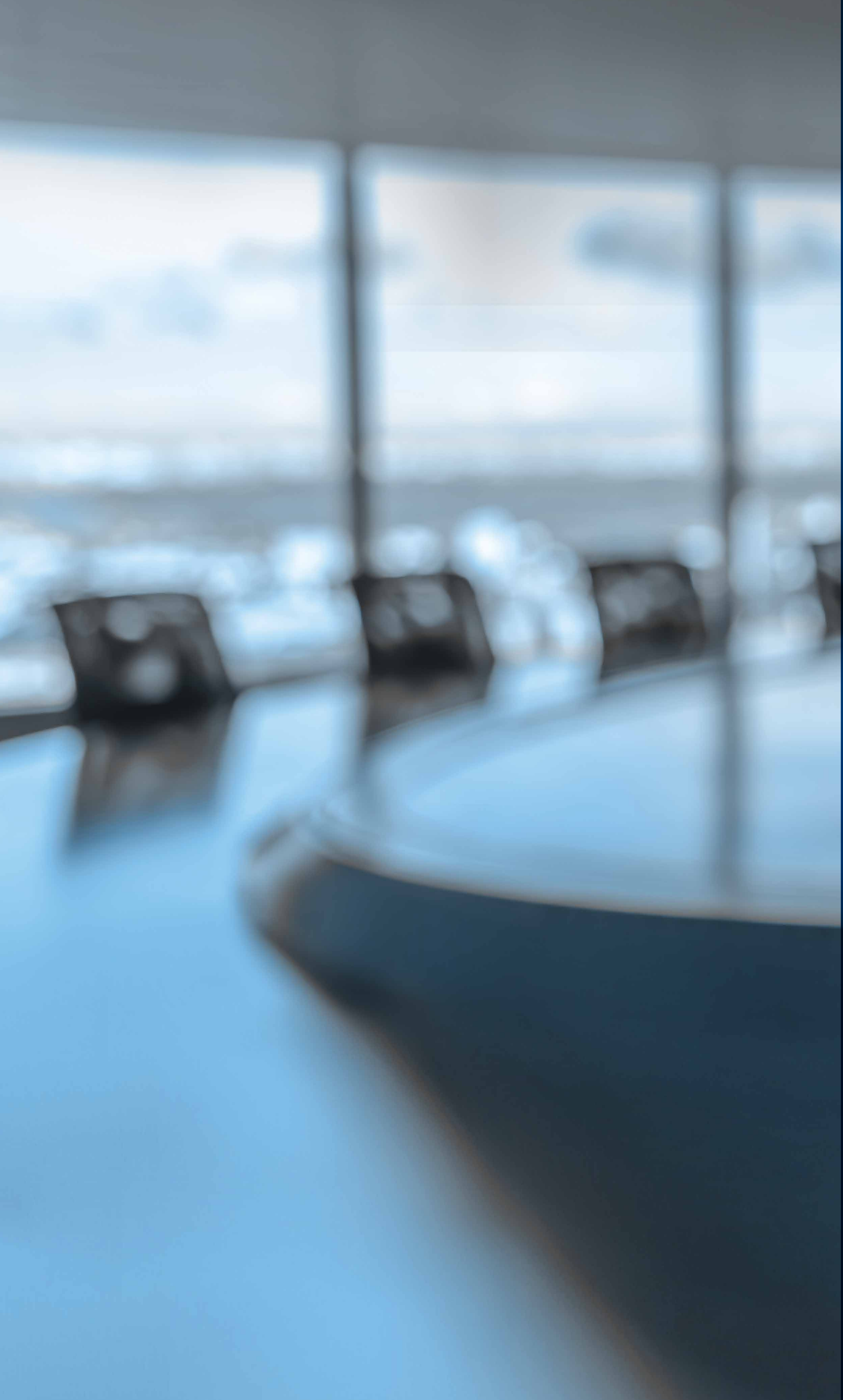
# DIRECTORS DIALOGUE *Digest* 2018



## 10th Anniversary Edition

As the role of the public company director continues to evolve, board members are faced with increasingly complex decisions. To successfully navigate this environment of rapid disruption, governance must evolve to a new standard, one that is increasingly proactive, pragmatic, and collaborative.

The Raj & Kamla Gupta Governance Institute hosted its 10th annual Directors Dialogue program in April 2018 bringing together 40 corporate directors representing 52 public, 29 private, and 59 nonprofit boardrooms from across the country to address current trends, debated topics, and the future state of corporate governance.

We present here some of the key insights gained during this notable program.

DREXEL UNIVERSITY
Raj & Kamla Gupta Governance Institute
*Center for Corporate Governance*

# *Director Involvement* in Shareholder Engagement

**With the constant evolution of the director's role, shareholder engagement continues to be top of mind.**

It is a contentious topic; experts say it's a key practice for boards to engage directly with shareholders, but not all boardrooms share that view. Engagement presents the opportunity to develop relationships and build trust with investors, but opponents argue that director involvement invites chaos and can muddle the company's message. So, the question remains: Should directors play a part in shareholder engagement?

Companies also continue to face capital allocation decisions. What is the best use of their money, and how can they serve their shareholders? All of these questions come against a backdrop of potential new regulatory changes brought by the new administration.

Directors representing 50 public companies with market caps ranging from $300M to $240B came together on April 4 in Philadelphia for a candid, closed-door discussion of how they are confronting these boardroom topics. They engaged with experts from the SEC, large institutional investors, and investment banking and private equity investment professionals, among others. The panel discussions focused on regulatory reform, capital allocation and spin-offs, strategy and risk in an age of digital disruption, and defining the future state for boards. One theme consistently came through during the talks: the need for the board and the company to be agile and ready to make quick decisions, and, if need be, to pivot.

**Director/Shareholder Engagement is an Opportunity:** Experts agree that direct engagement with shareholders helps to build trust and confidence in the board. An ongoing relationship presents a two-way street of opportunity—shareholders can gain insight into the board's stated strategy and level of engagement, and directors can hear shareholder priorities firsthand. Boards and management should not wait until they have activist pressure to determine who they should talk to at Vanguard, BlackRock, or any other institutional investor. Annual or bi-annual engagement by directors can foster trust with investors, which can be drawn upon during periods of turmoil.

**Director/Shareholder Engagement is Not Without Risk:** Despite the opportunities, some view director engagement with shareholders as a "slippery slope" that may result in too many messengers with differing messages. Some believe that the CEO should be the sole spokesperson for the company, articulating a single view on behalf of the board and management. Members of the board might present a diverging opinion that can open the floor to disagreement and confusion. There is an inherent challenge in having multiple messengers communicating the company's story. Boards should thoughtfully evaluate who they choose to serve as their representative to speak with management to investors, to ensure that they effectively communicate one story.

## OPTIMIZING SHAREHOLDER VALUE

It is often said that a board of directors' greatest responsibility is to thoughtfully optimize shareholder value, but how is shareholder value defined? Management and the board need to reach a consensus on what metrics define that value based on the long-term strategy of the company. Increasing long-term shareholder value may not always drive short-term shareholder happiness, so it is important for boards to consider, "what am I solving for and over what period of time?"

**Internal Alignment is Critical:** There is a need to ensure that the board's definition of shareholder value aligns with management's definition. Often, misalignment between the board and the management team can stem from different definitions and paradigms of shareholder value. In defining shareholder value, the board should identify the criteria that they deem most important to measuring success. Once this has been determined, the board and management must agree on a metric to define shareholder value, and remain aligned on what success and failure look like. Shareholder value must be internally defined before it can be communicated externally.

**Shareholder Validation:** Once boards have their definition of shareholder value set internally, they must externally validate it by demonstrating their internal alignment on its definition. Shareholder value must be validated by shareholders to deliver the maximum value. Boards must communicate their definition of shareholder value outwardly to ensure that it matches investor expectations and constitutes a definition that is relevant to and valued by the shareholders.

**Shareholder Value is Relative:** There is often an inherent disconnect in measuring shareholder value; companies tend to define it over the long-term, but evaluate and respond to short-term fluctuations in value. Directors should be looking at shareholder value in a relative sense, rather than an absolute one. Shareholder value is often measured in static periods, especially when the metrics are reported to investors. However, viewing changes to shareholder value in the context of industry and economic performance can provide a better picture of overall company performance. Doing so allows boards to engage in continuous strategic planning, consequently adjusting shareholder expectations dependent upon performance.

*"We can measure shareholder value in a lot of different ways, but it's primarily about having the board and company management aligned on a measure, rather than the specific metric itself."*

– Matt Espe
*Director, Realogy Holdings Corp & WESCO International, Inc.*


*"Boards today are more representative of the societies they serve."*

–Maureen Breakiron-Evans
*Director, Ally Financial Inc., Cubic Corporation and Cognizant Technology Solutions*

## A LOOK AT THE CURRENT REGULATORY LANDSCAPE

**The Decline of Public Companies:** Over the past decade, the number of public companies has declined by roughly half. Many companies are opting to stay private longer, following the example of the large number of successful "unicorns" and private-equity backed ventures. The SEC is taking actions to make it easier for companies to be public, reviewing disclosure requirements to make the move into the public sphere easier on a company. These include the proposed changes to modernize and simplify the disclosure requirements of Regulation S-K and the Fixing America's Surface Transportation (FAST) Act. Additionally, the SEC looks to ease the burden of annual required disclosures in the MD&A section of the 10-K form.

**SEC Accessibility:** The SEC is also working to be more collaborative and responsive to issuers. Historically, the SEC has had an open door for interest groups and registrants to come in and ask questions. However, people stopped coming to the SEC, even when it was beneficial for them to do so, because it felt too difficult. The current leadership is doing everything they can to revive and maintain the accessibility of the SEC. It has made changes to encourage public filings, such as having all companies file for public offering confidentially in the first year to avoid the market-moving effects of filing. They have also taken steps to institutionalize the updated processes, for instance replacing the general help lines previously used by the SEC with specific phone lines for dedicated topics on which the SEC provides guidance.


## THE FUTURE STATE OF GOVERNANCE

For corporations to continue to be successful, governance must evolve. There are many driving forces behind the future state of governance: shareholders have become increasingly impatient with below-market performance, market disrupters like activist shareholders and private-equity firms have become key players that cannot be ignored, and the number of public companies has declined by almost half in the past twenty years. These factors have created the perfect storm, one that is already being recognized by business leaders. Larry Fink's letter to CEO's and the creation of the Commonsense Corporate Governance Principles, signed by the Institute's Executive-In-Residence Bill McNabb, have called for changes to corporate governance and the start of a dialogue around what the future state of governance will look like.

**Proactively Anticipating Change:** As disruption is part of today's lexicon, directors are being asked to strike a balance in thinking about their current and future states. Given the rapid pace of change we're currently experiencing, it is important that boards be agile. Rather than waiting to see what change brings, boards must be proactive and anticipate disruption. Boards should consider what changes their industry may go through, and proactively build their capabilities for the future. The board's role in ensuring management can quickly act to adjust company direction or strategy will be critical in coming years.

**Long-termism:** Over the past decade, boards have been forced to respond to various "shocks to the system." Boards need to be at a generative stage, and adjust their agenda to focus on long-term thinking. For too long, companies have focused on generating short-term results for investors at the expense of their long-term outcomes. The best companies are those that have both short and long-term plans, and who are thinking through strategy on multiple levels. In this new era of rapid change, boards need to ensure their companies focus on delivering long-term value to shareholders.

**Strong Board and CEO Partnership:** One of the ways in which companies can ensure prioritization of long-term goals and results is to align the board and CEO in a strong partnership. There must be a new level of transparency and trust between the board and management. The board needs to be able to question the decisions of management and the status quo to keep the company moving in the right direction. Focus should be on the dynamics between the two and what the culture of the board accomplishes, as opposed to what its structure does. Doing so will open the door for honest discussion and allow boards to highlight good practices.

As corporate governance continues to evolve, the Raj & Kamla Gupta Governance Institute will continue to be at the forefront of the discussion about the future state of governance. We at the Institute are committed to redefining leading governance practices of the future.

DREXEL UNIVERSITY LEBOW COLLEGE OF BUSINESS

# Raj & Kamla Gupta Governance Institute

*Advocating for improved governance practices for public, private, and nonprofit organizations through programming, knowledge sharing, and research.*

The Raj & Kamla Gupta Governance Institute uniquely aligns its preeminent academic research with diverse industry perspectives through its Advisory Board representing more than 60 public, 45 private, and 95 nonprofit boards. As a result, the Institute has the agility to develop cutting-edge programs and publications that support issues top-of-mind in today's boardrooms.

The Raj & Kamla Gupta Governance Institute is home to both the Center for Corporate Governance and the Center for Nonprofit Governance, each providing world-renowned business leaders with dynamic governance insights. The Centers are the region's foremost governance leaders in shaping and influencing public, private, and nonprofit boardrooms, nationally and internationally.

As a part of the LeBow College of Business, the Raj & Kamla Gupta Governance Institute embodies the rigor of A.J. Drexel's mission to be the neutral ground where industry and education meet to provide Business Solutions through its programming, knowledge sharing, and research.

## Center for Corporate Governance

The Center for Corporate Governance (CCG) within the Raj & Kamla Gupta Governance Institute focuses its research and programmatic efforts on advocating for leading corporate governance practices in the public and private company space.

CCG provides resources and a forum to foster cross collaboration between preeminent academics, business leaders, policy makers, and other practitioners as they discuss and advocate for meaningful, substantive positions in corporate governance.

Through its signature programming including Directors Dialogue and Directors Academy, as well as its collaboration between academic research and industry expertise, CCG guides directors and other practitioners as they lead and advise corporate boards and discharge their fiduciary obligations.

## Center for Nonprofit Governance

The Center for Nonprofit Governance (CNG) within the Raj & Kamla Gupta Governance Institute focuses its research and programmatic efforts on advocating for leading nonprofit governance practices in the nonprofit sector.

Founded in 2018, the Center for Nonprofit Governance is committed to developing key research that shapes and influences dialogues among nonprofit boards and leadership in our region about the alarming state of the sector and the role nonprofit boards should play.

Through the Institute's three key pillars, research, knowledge sharing, and programs, the CNG aligns its efforts with the work of Drexel University to positively impact the nonprofit sector in its entirety.

DREXEL UNIVERSITY
Raj & Kamla Gupta Governance Institute
LeBow College of Business

Gerri C. LeBow Hall
3220 Market Street
Philadelphia PA 19104