Investing is key to long-term success

The long-term sustainability and success of large companies depends on a variety of factors, many of which are influenced by the actions of boards and their compensation committees. Recent events, including an eventful proxy season, a prolonged pandemic, and a shortage of skilled workers, have caused boards to prioritize their companies' long-term approach to social and environmental issues. In September, CCLN members convened for two separate sessions to discuss these and related issues.

On September 14, 2021, CCLN members met with Yumi Narita from the New York City Comptroller's Office and Maher Colaylat from State Street Global Advisors (SSGA) to delve deeper into governance and pay issues. On September 30, members were joined by Guild Education CEO Rachel Carlson and Rock Central chief learning officer KimArie Yowell for a discussion on upskilling the workforce.[1] *For a full list of meeting participants, please see the appendix on page 5.*

Investor perspectives on pay and governance

In a dialogue with institutional investors, compensation committee chairs discussed corporate governance hot topics, executive compensation trends, and the importance of corporate disclosure and engagement:

- **Environmental, social, and governance (ESG) issues are top of mind.** Faced with pressure on ESG issues, compensation committee chairs were interested in learning more about how investors set their priorities. Mr. Colaylat said that SSGA is focused on areas in which policy changes can lead to outsized results: *"We focus on where we see the potential to create value. Our focus areas for the next few years, climate change and human capital management, are ones we see as having significant risk but also ample opportunity."* The areas of emphasis are often influenced by their own investors. Ms. Narita noted that as the steward of city employee pension funds, the New York City comptroller's office presses issues that are important to their funds' beneficiaries: *"Diversity is incredibly important to the teachers and city employees in New York, so we did a campaign around EEO-1 disclosure because we want leaders to be accountable for reporting on the diversity in their own companies."* Mr. Colaylat echoed that sentiment: *"Many of our clients want to see significant change, too. We face pressure from the investors in our funds to focus on different ways of making an impact."*

- **Committees should be sure they have identified the right ESG metrics before including them in pay plans.** The investor guests were unambiguous that boards and CEOs should establish tangible, strategically linked nonfinancial goals. They also stressed, however, that compensation committees must be comfortable that they have selected the right ESG metrics before including them in compensation plans. One member asked, *"Do investors want to see movement away from compensation plans that are formulated based on hitting the financial objectives, to more balanced scorecards that include ESG metrics and more informed judgement on behalf of the board?"* Ms. Narita did not express a preference; instead, she encouraged compensation committees to explain their decision: *"Currently, there aren't that many companies that are tying ESG factors into their compensation plan in a way that is very transparent to investors."* Mr. Colaylat noted that if a committee decides to incorporate ESG performance into pay plans, it is still important to use measurable goals: *"Just because you are assessing an area like culture doesn't mean there can't be quantifiable metrics and targets involved in its assessment."* Some members struggled with the balance between paying for financial and nonfinancial performance. Some pointed out that long-term investments—those aimed at reducing carbon emissions—can be a drag on earnings or other metrics that are used in pay plans today. Mr. Colaylat did not anticipate SSGA or others being prescriptive about the percentage of pay to allocate to nonfinancial goals: *"Ultimately, we elected these board members, and we trust in their abilities to make the right decisions when it comes to executive compensation."*

- **Conventional incentive practices raise questions in an unconventional time.** The volatility of the past two years has led some to question whether committees should revisit their approach to short- and long-term incentive plans. The investor guests raised concerns about cases in which a business cycle appears out of sync with a pay plan. Ms. Narita said, *"A five-year business cycle strategy paired with a compensation plan that is evaluated every three years does not line up well."* Given the wide range of perspectives on this issue, however, network members noted that it would take a lot to consider a major change. The investor guests specifically encouraged members to enhance transparency around one-time or unusual payments. Ms. Narita said, *"During the pandemic, retention bonuses were paid to executives, in a down market, but, ultimately, the board thought the executive might jump ship to another company. These transactions didn't make much sense to investors, so more transparency is needed to keep the trust between investor and compensation committee."* Mr. Colaylat added, *"I think it's important for companies to recognize there are some investors that will not trust the use of qualitative metrics. This just highlights the need for more detailed and robust disclosure of these areas."*

- **Investors are more deferential to boards that tell their stories in detail.** On ESG issues and more broadly, investors clamor for more information about company and board decision-making practices. While acknowledging that there are some sensitive areas Ms. Narita encouraged directors to consider providing more information, especially on social issues: "For example, we are looking for racial and ethnic disclosure on individual directors. It sends a message from the top that there is diversity as well as accountability in the boardroom." Mr. Colaylat added, *"We are looking for explicit disclosure of how these different areas fall into long-term strategy and how, ultimately, the board is overseeing these areas and how material they are to the company."* He emphasized a desire for disclosures that include a coherent message supplemented with metrics that can be tracked over time. Ms. Narita noted that when investors do not get information directly, they end up using third-party data instead: *"Companies sell themselves short when they allow third parties like MSCI or Glassdoor to be the data points for these investors, instead of reporting a bit more of that data themselves."* Disclosures themselves are not always enough; investors also find value in direct engagement. One compensation chair asked, *"Who do you like to stay in touch with? What is the preferred cadence of how you like to stay in touch with them, and what are the kinds of things you like to see?"* Both guests encouraged regular engagement. In some circumstances—like a major change to a pay plan or in response to a negative say-on-pay vote—it makes sense for the compensation chair to be part of the dialogue. In such situations, Mr. Colaylat stressed, *"What we really want to see is the compensation committee members demonstrate their knowledge. There have been too many conversations where board members have started off the conversation and then handed it over to somebody else to get into the details."*

The many benefits of enhancing skills and training

CCLN members engaged with Guild Education's Ms. Carlson and Rock Central's Ms. Yowell about the most effective ways for companies to invest in their workforces. The following themes emerged from the conversation:

- **Workers needs new skills to sustain companies for the long term.** Many of the tasks employees will perform in the future will be very different from the ones they do today. As a result, *"Many Americans don't have the skills to have a family-sustaining wage 5 to 10 years from now,"* according to Ms. Carlson. This, coupled with the competitive marketplace for talent, leaves companies eager to upskill and reskill their existing employee base. Ms. Carlson's company, Guild Education, brings employers and learning providers together to offer debt-free education and upskilling opportunities to America's workforce. Ms. Yowell shared the challenge that her company and its approximately 26,000 employees faced: *"We are constantly innovating and evolving as a fintech company. We had an extreme need for technological skills and desire to grow our talent from within, in addition to attracting talent from Silicon Valley to Detroit."* She noted that historically, employee learning programs struggle to gain traction due to three barriers: time, money, and fear. While there are many benefits to programs that enable employees to pursue degrees or certificates, companies can also tap into more inclusive talent pools by changing hiring requirements that screen for educational experience. One member shared, *"I'm seeing companies abandon previous criteria for screening job applicants. We used to require certain degrees* *but have shifted to seek people with skills that align with the job requirements."* Ms. Yowell added that the barrier of college degrees as job prerequisites eliminates a large percentage of women and people of color. One director reflected, *"This conversation shows how important it is to be thinking about the whole house, and how we're shoring up that base because, at the end of the day, that is where the bulk of the employees sit, and that's what makes or breaks the organization."*

- **Upskilling and reskilling deliver a variety of benefits.** There are ancillary benefits for companies that invest in workforce training and development. Ms. Yowell said, *"Our program helps us attract great talent into our organization, because team members want to work in a firm that has a very clear purpose and mission, but they also want to work in a place that's going to invest in them."* In addition to attracting talent, these investments help companies with employee retention. Ms. Carlson said, *"The hard turnover cost of a frontline employee is $7,000, and it only goes up from there—in technology, it can cost $60,000. That is astronomical compared to the investment in them that might make them decide to stay."* Compensation chairs agreed that nearly every company has room to improve its approach to employee retention. One said that this begins by elevating the topic to the board level: *"The boards I am on have spent lots of time talking about mobility, flexibility, DEI, and recruitment. But I don't feel like we have done the job talking about retention and all the elements of that, from motivating people to upskilling and continued learning. It's an opportunity."* Educational benefits are just one form of long-term investment in people. One member said, *"I think there are three ways to develop talent: (1) formal training, which we've been talking about. A continuous-learning organization is so critical to a company and an individual's success. (2) On-the-job training. Learn by making mistakes and create a culture that is tolerant of that. (3) Finally, one of the most important things is the availability of mentoring and coaching. I think this combination is how you build a culture that is inclusive, and that, in turn, results in retention and loyalty."*
- **Goals for employee development must be linked to business strategy.** The success of employee training programs can often depend on the support and sponsorship it receives from senior management. One member said, *"Companies trying to drive learning can't do so unless it starts with the CEO and the entire management team. It needs to be part of how you operate."* Ms. Yowell agreed: *"Our entire C suite is at the table in these conversations because it is important for our education program to be aligned with the organizational strategy."* Compensation chairs were interested in how best to measure the outcomes of their companies' investments in employee training and development. Ms. Carlson said, *"We start by linking our measurements to the strategic talent priorities of the company. Recruitment is always important, so we set targets like increasing high-quality applicants by 25%. We track turnover and DEI mobility metrics as well."* Ms. Yowell added that her team is focused on the percentage of employees that take advantage of the resources that the company is offering: *"We are tracking how many employees complete*

an application and then actually enroll. We track our tuition assistance investment, and we have seen an uptick as employee engagement increases. We also track movement throughout the organization among employees who participate in the program, the kinds of roles these employees are moving into, if they are being promoted at a higher rate, and how their compensation changes." Ms. Carlson also encouraged compensation chairs to empower the employees who oversee learning and development at their companies by encouraging a direct reporting line to the CEO and ownership of their own budget.

Appendix: Meeting participants

The following directors attended at least one of the two sessions:

- Homaira Akbari, Temenos
- Gaurdie Banister, Tyson Foods
- Tony Earley, Ford Motor Company
- Helene Gayle, The Coca-Cola Company
- Lisa Gersh, Hasbro
- Mirian Graddick-Weir, Booking Holdings
- Worthing Jackman, Quanta Services
- Annette Leckie, Meridian Compensation Partners
- Karen Maidment, TD Bank Group
- Denise Morrison, Visa
- Meg Porfido, Kaiser Permanente
- Virginia Rhodes, Meridian Compensation Partners
- Laurie Siegel, Lumen
- Amanda Sourry, PVH
- Matthew Winter, The Hartford

Endnote

[1] *Summary of Themes* reflects the network's use of a modified version of the Chatham House Rule whereby names of members and their company affiliations are a matter of public record, but comments made before and during meetings are not attributed to individuals or corporations. Guests, however, have given permission for their remarks to be attributed. Comments by guests and network members are shown in italics.