Compensation Committee Leadership Network

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CCLN

VIEWPOINTS

Corporate purpose and the post-global world

Corporate leaders have always had to contend with disparate factors when making decisions about the future of their businesses. Recently, the debate has been about whether the primacy of shareholders or the integrated interests of all stakeholders should drive those decisions. This debate is occurring during a unique geopolitical moment: companies are grappling with the simultaneous and rapid development of disruptive technologies and skepticism about globalization that is challenging the global economic order.

On October 28–29, 2019, members of the Compensation Committee Leadership Network (CCLN) met in Washington to discuss these and related issues for boards and compensation committees. For part of the meeting, they were joined by Maria Ghazal of the Business Roundtable for a discussion on corporate purpose. Paul Laudicina and Erik Peterson of AT Kearney's Global Business Policy Council (GBPC) joined members for a dinner conversation about geopolitical and macroeconomic trends facing global companies. Members also participated in an off-the-record session with William Hinman, director of the SEC's Division of Corporation Finance. Finally, members discussed issues and trends their compensation committees are addressing as we approach the end of the year. This *ViewPoints* synthesizes these discussions.[1]

A broader corporate purpose: serving all stakeholders

In August 2019, the CEOs of 181 companies signed the Business Roundtable's (BRT) Statement on the Purpose of a Corporation and committed to lead their companies for the benefit of customers, employees, suppliers, communities, and shareholders.[2] Since 1978, the BRT has periodically issued Principles of Corporate Governance. In 1997, the CEOs adopted shareholder primacy language and the language was reaffirmed in subsequent versions of the Principles including most recently in 2016. But this new announcement outlines what the BRT calls "a modern standard for corporate responsibility,"[3] in which a broader range of stakeholders are considered in corporate decision-making processes. Maria Ghazal, senior vice president and counsel for the Business Roundtable, joined members to discuss the long-term implications of this policy shift.

Ms. Ghazal shared some background on the process that led to this statement: *"This really began with critics asking us why our language changed in 1997. We went back and reviewed all the versions. We spoke to outside counsel from 1997 and we undertook a comprehensive study of the topic, speaking to over 30 academics and other experts. We went back to the CEOs and the first thing they said about the 1997 statement was that it didn't match how they* *run their companies in 2019. And that was when the CEOs said words really do matter and the drafting and approval process was set in motion. This ultimately led to asking each CEO to personally sign the statement."*

Response to the policy statement has been mixed

The BRT's Statement has garnered plenty of support, but also criticism: some say it goes too far by pushing shareholders to the end of a long list of stakeholders, and others say it does not go far enough toward holding management accountable to those other stakeholders. Among the critics is the Council of Institutional Investors (CII), a large association of pension funds and other asset owners. CII issued a response expressing concerns that the statement undercuts notions of managerial accountability to shareholders.[4] The response adds that "if 'stakeholder governance' and 'sustainability' become hiding places for poor management, or for stalling needed change, the economy more generally will lose out."[5]

In response to both the BRT and the CII's response, corporate lawyer Martin Lipton of Wachtell, Lipton, Rosen & Katz released a statement in support of the BRT's premise:

> The failure to recognize the existential threats of inequality and climate change, not only to business corporations but also to asset managers, institutional investors and all shareholders, will invariably lead to legislation that will regulate not only corporations but also investors and take from them the ability to use their voting power to influence the corporations in which they invest. Inequality and climate change will not be mitigated without adherence to the BRT governance principles not just by members of the BRT, but by all business corporations.[6]

The timing of this conversation coincides with the US presidential election and therefore has become somewhat politically charged. Senator Elizabeth Warren weighed in on the BRT statement and asked the CEOs who signed the document to put their words into action.[7] In letters sent to CEOs of 10 of the largest public companies listed as BRT signatories, Senator Warren said, "If you, and the other 181 corporate executives who signed the BRT's new Statement on the Purpose of a Corporation, plan to live up to the promises you made, I expect that you will endorse and wholeheartedly support the reforms laid out in the Accountable Capitalism Act (ACA) to meet the principles you endorse."[8] CCLN members viewed the BRT's statement and the additional attention it brought as an opportunity for corporate leaders to think differently about major corporate decisions. Some raised questions as to whether it would really change the way boards approach these decisions, however, noting that successfully serving the interests of shareholders requires taking other stakeholders into consideration.

Some investors are increasingly pressuring companies to focus on stakeholders

Members noted that many investors are pressing companies to pay more attention to a broader set of stakeholders. One said, *"In recent engagements, shareholders are asking us about environmental and social issues. They want to know what we are doing to put customers first."* Members said much of the attention has focused on employees, with pressure to enhance disclosures related to human capital management and other non-financial matters.

In August 2019, the SEC proposed amendments to Regulation S-K that would update the rules for disclosures and simplify compliance efforts for registrants.[9] They would "include, as a disclosure topic, human capital resources, including any human capital measures or objectives that management focuses on in managing the business, to the extent such disclosures would be material to an understanding of the registrant's business, such as, depending on the nature of the registrant's business and workforce, measures or objectives that address the attraction, development, and retention of personnel."[10]

The implications for boards and management

Members debated whether a shift in corporate purpose would drive CEOs and other corporate leaders to change their decision making. A member asked Ms. Ghazal how the BRT is thinking about putting this statement into action: *"Was there discussion about how business would be conducted differently?"* Ms. Ghazal responded, *"Each CEO will determine what this means at each company. It is not a statement that implies all companies will do the same thing."* Ms. Ghazal emphasized that the BRT statement speaks for CEOs, *"We don't speak for boards, or employees, or other stakeholders.* Overall, members did not expect that complying with the BRT's statement would require a significant change at their companies. One said, *"High-performing companies are already doing this strategically. To be a sustainable enterprise, you need to think differently about attracting talent and investing in the future, while driving returns at the same time."* However, a member with experience serving on the board of a company legally required to consider all stakeholders said doing so can require a mindset shift: *"For most issues, the process doesn't change. But if something major happens like M&A, we have to go through how it effects every stakeholder."* Another member noted that the consequences would likely depend on the company: *"I don't think all companies are doing this naturally, but many of the leading CEOs who signed this are already doing well in the market—I'm not sure this statement will force a change for them."*

Some members are starting to have board-level conversations about the practical steps they can take to incorporate stakeholder considerations, though one described the current discussions as *"baby steps."* Another said, *"This statement has generated more thought on our corporate purpose. We all have one, but we don't always talk about it in those terms. It's bringing back that sense of 'Why do we exist and how do we re-articulate it?'"* A member proposed that each company's leaders will have to decide if they believe that factoring stakeholders into all decisions will in fact create long-term value: *"If you believe the underlying premise you don't want to drag your feet and miss an opportunity, so you need to figure out the rate you go at to put this in action. If you think its window dressing, you probably won't change much."*

The challenge of using nonfinancial metrics in compensation plans

Members wondered whether a pledge by CEOs to serve all stakeholders might prompt a reassessment of pay metrics. None anticipated a major or immediate change. However, several noted that they are having more conversations about incorporating nonfinancial, stakeholder-focused metrics into CEO pay. One said, *"The first step is developing ways to measure progress on this dimension. There is a broad mix of very important topics. If this plays out, we need to decide what metrics to use and how they are incorporated into compensation."* Another added, *"I really do believe in the long-term value creation of focusing on all stakeholders and there are increasingly more studies that prove the connection. But I still think more needs to be done to understand the relationship of investing in people and ESG to an actual metric. Better data around that would help."* Ms. Ghazal said that the BRT is speaking with various stakeholders to better understand what information would be useful to help companies tell their stories in a more consistent way.

CCLN members pointed out that there are some measurements already being used to understand employee and customer satisfaction. They hoped that over time a more standard set of metrics would allow boards to better benchmark performance against peers but noted that this is easier for some categories of metrics than others. One said, *"We have Net Promotor Score for customer satisfaction which is standard across many businesses and it's a helpful way to compare and contrast. We also have employee engagement surveys and we can look at those compared to others and say, 'Where did we fall short?' So as BRT thinks about metrics, I don't think a single method for ranking companies against each other is what we are looking for but comparability is helpful."* Another member pointed out that creating a metric to measure community satisfaction would be especially challenging.

Meridian Compensation Partners' Marc Ullman expressed a desire for more clarity in this area as committees consider how to incorporate ESG performance into pay plans: *"Many business decisions are based on financial modeling. It would be great to have something like a discounted cash flow model for the ESG space. Yes, there are studies suggesting there is real value in ESG but until there are stronger metrics and more direct ties, companies are still taking a bit of a leap of faith because it feels right."* While efforts to improve measurement and comparability will continue, one member noted that precise metrics may be impossible: *"I'm not sure we will ever come to a simple metric. I think it's something management takes to the board when they talk about strategy and they look at it and think about it but to actually* *translate it to a measurement? It will be really hard to come up with something that works across industries."*

Committees are considering expanded clawback policies even without a final SEC rule

As mandated under the Dodd-Frank Act, the SEC has proposed (but not finalized) rules directing national securities exchanges to establish standards requiring listed companies to develop and enforce recovery policies that, in the event of an accounting restatement, may "claw back" incentive-based compensation from current and former executive officers. Recovery would be required without regard to fault. The proposed rules would also require disclosure of listed companies' recovery policies, and their actions under those policies.[11]

Several members discussed recent deliberations about the scope of their clawback policies; in particular, some are considering the parameters for clawbacks in cases that are not related to a financial restatement. One member said, *"We have engaged in discussions on clawbacks beyond restatement. Our philosophy is not to be the leading edge on this policy, but we want to be ahead of the median. We are debating with certain behavior, should there be a financial punishment if something rises to the level of materiality? We have not instituted anything yet."* Another said, *"I'm not sure why it's such an emotional issue. If you do something really bad that causes the company a big financial penalty, of course we should be able to pull it back."*

Most members discussed policies where the trigger point for a clawback was termination for cause. One member, however, described expanding a policy to include broad language in the event of a code of conduct violation for existing employees: *"We discuss it with management on a lookback basis and if an individual operated outside of the code of conduct, we debate the appropriate financial impact—it's discretionary to the committee. It can have a huge impact on the organization. Reputation is everything."* In one case, executives are asked to sign the code of conduct, making it a legal contract. Others, however, noted organizational resistance to a policy that lacks clear parameters. One said, *"Some people get concerned when the whole program becomes 'You will trust the board' that your action harmed the company."*

Corporate strategy in a post-global world

Factors tied to both technological innovation and distrust of government are raising questions about the role of the private sector in society.[12] Mr. Laudicina discussed some of the principal drivers of today's global business conditions: (1) decreased globalization; (2) shifting demographics; (3) localized consumer behavior; (4) attention to the environment and natural resources; and (5) changes in government and governance. He added, *"The driver on top of all of this is technology. We have moved from an environment of labor arbitrage to knowledge arbitrage to value arbitrage, and all this is leading to an even more profound generational divide."*

Forces of technology and deglobalization are at play

Technology creates opportunities but can also bring about disorder. Mr. Peterson described the tension: *"The speed of technologies like artificial intelligence (AI), the internet of things, robotics, augmented reality, and 3D printing allows companies to do things we once thought impossible. It is also the beginning of a long march toward an even wider digital divide between nations."* One member raised concerns about those who are left behind: *"In the past, we've seen the Luddites who didn't like the future and wanted to destroy it. I'm worried about a Luddite-like response."*

Mr. Laudicina said that the backlash against globalization is leading a growing number of consumers to favor local goods. Meanwhile, technology like 3D printing is driving a new era of localized supply chains to meet those consumers' demands.[13] *"Companies globally must rethink their entire value chain, from strategy formulation to product design, to production, to marketing, to procurement, to supply chain, to consumer engagement,"* said Mr. Laudicina.

The Sino-US technology rivalry heats up

Members were interested in the race between China and the United States to be the global technology leader. Mr. Laudicina said, *"The competition is just beginning. The Chinese have a centrally organized approach supported by government resources, and they are not restricted by the same ethical boundaries we put in place. The US has taken a more laissez faire approach."* Mr. Peterson added, *"The Chinese used to copy American models. They've now reached a threshold where they generate their own intellectual property."*

In a recent GBPC white paper, they pointed to artificial intelligence as the key technology to watch in this competition:

> With eighty percent of global value in AI technology concentrated in either the United States [or] China, the battle is essentially between these two "AI superpowers" and their emerging, distinctive and competing digital ecosystems. This leaves most economies unable to fully capture the value of AI and emerging technologies. It also places many other nations—and emerging markets in particular—at the forefront of Sino-American techno-national competition for digital infrastructure development.[14]

One member said, *"I'm worried about the implications of the US falling behind. What does that say about where the world is going? People used to look to the US and our values."*

The private sector debates a new leadership role

The rise of geopolitical disorder may create opportunities for companies to build more trust with stakeholders. One member noted, *"Surveys show that companies are now more trusted than governments."* Mr. Laudicina concurred, *"Younger workers are looking to their employers for far more than just business leadership. They want CEOs to take a stand and provide guidance on a much broader range of issues."* Mr. Laudicina told members: *"Companies can start by getting involved with state and local governments and getting millennials involved in the process and making them feel like their engagement makes a difference."*

Mr. Laudicina also noted that governments are unable to keep pace with the speed of technology adoption, creating a gap that the private sector may need to fill: *"The governance lag to respond with policy is getting wider and wider and it's creating a problem for the future."*

The GBPC white paper expounds on the challenges of relying on democratically elected governments to solve major problems:

> The new information landscape may favor less democratic governments—at least in the short term. The pace and volume of information and misinformation in today's digital environment is clearly straining democratic processes and policymaking. At the same time, envy of the Chinese model—characterized by controlled information flows and centralized decision-making—is growing. However, carefully nurtured democratic systems are less brittle than authoritarian ones—making them more capable in the longer term of absorbing the intensifying shocks that technological and societal change bring.[15]

Some members shared skepticism about corporations taking on a new role or supplanting governments. One said: *"I hate the process today but how do we break the cycle to change behavior? I think it's more complicated than businesses stepping up and doing more."* Another added, *"I'm not sure how that would work when there are trade wars with China. Companies can't step up and deal with this; it has to be governments."*

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Increased pressure to focus on a broader group of stakeholders, as opposed to traditional notions of shareholder primacy, has led some corporate leaders to expand their perspectives on corporate purpose. Geopolitical uncertainty and rapid technological advancement and disruption will continue to challenge governments and large corporations. In this environment, compensation chairs are looking to better understand how to measure performance against the metrics that matter most to stakeholders and to assess whether they should be incorporated into executive compensation plans.

About this document

The Compensation Committee Leadership Network (CCLN) brings together compensation committee leaders from North America's most prominent companies for private discussions about improving the performance of their corporations and earning the trust of their shareholders. *ViewPoints* is produced by Tapestry Networks to stimulate timely, substantive board discussions.

The views expressed in this document represent those of the Compensation Committee Leadership Network. They do not reflect the views nor constitute the advice of network members, their companies, or Tapestry Networks. Please consult your counselors for specific advice.

Appendix: meeting participants

- Beth Cobert, Compensation Committee Chair, CBRE
- Erroll Davis, Compensation and Benefits Committee Chair, Union Pacific
- Tim Flynn, Compensation and Benefits Committee Chair, Alcoa
- Helene Gayle, Compensation Committee Chair, The Coca-Cola Company
- Maria Ghazal, Senior Vice President & Counsel, Business Roundtable
- Marianne Harris, Management Resources Committee Chair, Sun Life Financial
- Don Kendall, Compensation Committee Chair, Talos Energy
- Jim Kennedy, Compensation Committee Chair, United Airlines
- Paul Laudicina, Chairman, Global Business Policy Council; Partner and Chairman Emeritus, A.T. Kearney
- Karen Maidment, Human Resources Committee Chair, TD Bank Group
- Erik Peterson, Partner and Managing Director, Global Business Policy Council
- Virginia Ruesterholz, Compensation & Management Development Committee Chair, The Hartford
- Marc Ullman, Partner, Meridian Compensation Partners

Tapestry Networks was represented by the following:

- Dennis Andrade, Partner
- Amy Sampson, Senior Associate
- Eric Shor, Partner

Endnotes

[1] ViewPoints reflects the network's use of a modified version of the Chatham House Rule whereby comments are not attributed to individuals or corporations. Quotations in italics are drawn directly from conversations with network members and other participants in connection with the meeting.

[2] Business Roundtable, "Business Roundtable Redefines the Purpose of a Corporation to Promote 'An Economy That Serves All Americans'," August 19, 2019.

[3] Ibid.

[4] Council of Institutional Investors, "Council of Institutional Investors Responds to Business Roundtable Statement on Corporate Purpose," statement, August 19, 2019.

[5] Council of Institutional Investors, "Council of Institutional Investors Responds to Business Roundtable Statement on Corporate Purpose."

[6] Martin Lipton, "Stakeholder Corporate Governance," Wachtell, Lipton, Rosen & Katz, August 20, 2019.

[7] Elizabeth Warren, "Senator Warren Asks CEOs to Honor Their Commitments to 'Promote an Economy that Serves all Americans,'" news release, October 4, 2019.

[8] Elizabeth Warren, "Senator Warren Asks CEOs to Honor Their Commitments to 'Promote an Economy that Serves all Americans,'" news release, October 4, 2019.

[9] Securities and Exchange Commission, "SEC Proposes to Modernize Disclosures of Business, Legal Proceedings, and Risk Factors Under Regulation S-K," 2019-148, news release, August 8, 2019.

[10] Ibid.

[11] US Securities and Exchange Commission, "SEC Proposes Rules Requiring Companies to Adopt Clawback Policies on Executive Compensation," 2015-136, news release, July 1, 2015.

[12] "Top 10 Takeaways from the 2019 CEO Retreat," AT Kearney Global Business Policy Council, accessed November 19, 2019.

[13] "Top 10 Takeaways from the 2019 CEO Retreat," AT Kearney Global Business Policy Council, accessed November 19, 2019.

[14] "Top 10 Takeaways from the 2019 CEO Retreat," AT Kearney Global Business Policy Council, accessed November 19, 2019.

[15] "Top 10 Takeaways from the 2019 CEO Retreat," AT Kearney Global Business Policy Council, accessed November 19, 2019.