XCEO INK

June 15, 2010
Volume 5, Issue 2

XCEO, Inc.
www.xceo.net

Understanding Proxy Access: A Value Perspective

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Article Highlights

- Increased proxy access and voting requirements will bring significant change regarding the election of board directors. The constant barrage of mandates from the SEC continues to set precedence for board action.
- One of the most serious problems seen by General Counsels and Board Secretaries of many companies since this law has been implemented, is simply getting shareholders to vote.
- Trading volume suggests that more than 22% of investors are short-term investors whose interests can sometimes destroy company value due to the desire for immediate return.

In my last XCEO INK article, "Corporate Board Service: Is it Worth the Risk?", I discussed the unintended consequences of creating a regulatory environment that discourages a future generation of leaders from wanting to serve on the boards of our corporations. I again begin to think of another matter that may spur its own unintended consequences, no less serious, pertaining to the increased focus on proxy access and shareholder voting rights.

The terms "Proxy Access" and "Majority Vote Initiatives" mean different things to different people depending on your vantage point. In any case, we have all heard the discussions and debates, and we all have something at stake regarding this issue. The bottom line is that earlier this year the Securities and Exchange Commission (SEC) mandated that changes be made on how shareholders vote, and these mandates translate into significant differences regarding who is elected to serve on corporate boards.

I believe that increased proxy access is an attempt by the SEC to satisfy those shareholders who believe that they should be able to have more say on issues such as director election, director compensation, and other critical board issues. While I do understand the need for greater accountability, transparency and perhaps improved communication, I caution those who believe this new regulation will achieve that goal. It is bothersome when you consider that the clamor of few will change the roles of many, and that when the responsibility of leading the organization is removed from the directors and placed with shareholders, the outcome may not be what we expect.

As I mentioned in my previous article, whether you own stocks or mutual funds, whether you have a financial advisor or make your own trades, we are all investors. We invest in the companies for which we work, we invest in the cities we live in, our government and via our 401K and other investment vehicles, we are directly tied to Wall Street. This mandate affects each one of us.

At XCEO, we strongly believe in improving personal leadership in corporations and in the boardroom as the means for increasing shareholder value. Because we provide leadership and other consulting support to both boards and individual directors, this has been a very stimulating time of late given the many mandates passed down by the SEC. Almost daily we are informed of new laws, procedures and best practices for corporations. To that end, increased proxy access is a topic I see as the proverbial slippery slope in that we might not get what we asked for, and in the interim, create an avenue for future challenges.

Increased proxy access and voting requirements will bring significant change regarding how directors are elected. The constant barrage of mandates, this one included, continues to set precedence for board action. The SEC requires that institutional investors, i.e. your mutual fund managers, investment banks, etc., no longer should have the ability to vote for each individual whose stock they hold. The fact is, more than 30% of shares are held by institutional/retail investors. Moreover, another 30% are kept in mutual funds and other professionally managed investment vehicles.[1] Thus, this issue reaches a significant portion of the population.

Now, individuals are going to have to vote for themselves. Rules that went into effect last January prohibit broker-dealer voting in any proxy related issues, including director elections. This presents a challenge to

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companies that must establish quorum, requiring a certain percentage of votes. According to Risk Metrics, "Corporate America is gradually buying into majority-vote bylaws – mostly as a result of pressure from shareholders."[2] This will make the election of directors even that much more difficult when you have to reach at least 50% of the shareholders. So, each individual investor will vote. This is, not a problem in and of itself, but a significant problem if those individuals are not able to allocate enough time to be knowledgeable. Therefore, they are less informed.

There is no doubt that proxy materials are cumbersome. In fact, I think that a change in how companies publish information is long overdue. The challenge is that companies must produce information about personnel, sales, revenues, markets and products, that information which helps investors understand the fiscal health of the corporation. Strategic initiatives, public relations material, even information on the board and leadership teams must be provided. To that end, many proxies are 50 pages or more.

Unless it is your job because you are in finance or a financial services industry, I doubt that most regular Joe investors, part-time traders and the like, read them entirely. If you listen to the experts and minimize risk by investing in many different companies, this would be an arduous task. It is unreasonable to think that most shareholders read the proxy statements, and can therefore be prepared to vote intelligently on critical issues.

This is a serious concern for companies that require votes, but cannot easily communicate with shareholders. In this regard, SEC regulations on how and where companies must post information can be viewed as a step in the right direction. Communication becomes the fundamental element in how this will change board and shareholder interaction. In order to get a majority vote in electing directors, companies have to rethink how they provide information to their shareholders.

If individuals are to vote, yet they do not read the proxies, that means that there are fewer informed voters and it is now easier for these less-informed voters to have a larger impact on the future of the company. In fact, corporations now have to go back to the drawing board in terms of how they can get shareholders to not only be knowledgeable, but also to vote.

Companies are now considering other methods of communication such as Facebook and Twitter to disseminate very important information traditionally found in the proxy. Is it reasonable to assume that a shareholder can be informed, at least enough to vote on whether a director should be elected, in 140 characters or less? Are social networking sites the best medium for very detailed, often complicated corporate information?

The most serious problem for the General Counsels and Board Secretaries of many companies, however, is simply getting shareholders to vote. As a member of the Society of Corporate Governance Professionals, I attended a meeting titled "Challenges in 2010: What You and Your Board of Directors Should Expect". We discussed risk oversight, director nominations, succession planning and many other challenges consistently faced by boards. What I didn't expect to hear about as a top concern for boards, is establishing quorum, which was discussed by the panel at length.

The General Counsel of a major, Fortune 100 company offered that his team proposed planting a tree for each shareholder who voted this year. Another very prominent Board Secretary volunteered that her company was sending a reusable grocery shopping bag to its shareholders who would vote. Having to provide bags and trees to entice voting? I doubt if this is what the activists had in mind when they pushed for increased access. I believe it is inconsistent for shareholders to clamor for their right to access, and yet many shareholders must be coaxed into voting by a gift.

My question is this: If we determine that the board of directors, a group of qualified business professionals, experienced and independent people, are not able to make the best decisions for shareholders, why would we assume that lesser-informed shareholders can make the best decisions for themselves? One of the fundamental arguments for greater access is that directors have a personal stake that makes them subjective in their actions. However, how can you argue that shareholders are more objective than directors? You may suggest that shareholders are owners of the companies, but in most cases, so are the directors.

Short-term investors are by definition not interested in long-term shareholder value. Although it is difficult to ascertain whether an investor is long or short-term, trading volume suggests that more than 22% of all investors are short-term investors whose interests can sometimes destroy company value due to the desire for immediate return.[3] Moreover, uniformed voters, individuals who are not as knowledgeable about the company and do not follow the company closely, are not likely to make better decisions than the directors elected to serve on the board.

Another traditional method shareholders consider for information include proxy advisory firms such as Risk Metrics, Glass Lewis and Proxy Governance. These firms make recommendations on how to vote on issues, provide information and many investment firms seek their guidance for their clients' portfolios. However, I believe, these firms are no more objective. Is it that investors prefer to rely on organizations such as these for independent information instead of trusting the judgment of the directors who know what occurs in the boardroom? My point is that we should not allow ourselves to simply rely on traditional methods of understanding boards. Organizations such as these provide valuable services to the investing community and they are certainly better informed and aware of the ins and outs of corporate boards than traditional investors, however they will continue to be outsiders looking in.

Changes to the access that shareowners have regarding proxy voting are significant because the concept is that it will improve the boards' accountability to shareholders. However, experience has taught us that laws and regulations rarely do the trick. I understand the need for progress. It is devastating to watch company after company fail because of a lack of leadership in the boardroom and executive suite. Retirement accounts have been decimated, jobs have been lost, confidence in our leadership has changed. Thus, we feel the need to do something. Proxy access is that something this time around.

Shareholders want increased value. Thus, when a board improves shareholder value, shareholders win. Winning for shareholders then is no different than baseball, soccer, any sport. If I want to win, I'm going to do what I can to improve my chances. In that case, I would certainly rather have the manager of the team, someone who is accountable, who is monitored and experienced and whose job it is to execute, to set the lineup. The manager is on the field every day, the manager knows the stadiums and the players. In order to win, I'm going to rely on the manager to choose the right players rather than count on the media or the fans to make the best decisions. Following this analogy, I would leave the judgment of which directors to select to those who know the job best, their peers.

I do not mean to imply that this proxy access law is good or bad. Neither am I passing judgment on whether shareholders should have the right to vote for the directors of the companies they own. As a shareholder myself, I believe that I should receive better communication from the board, and that we should take a more active role by being knowledgeable and informed. However, I question whether the shareholders who, for whatever reason, cannot be as informed, are not as involved or engaged in following the company's activities, can make the best decisions on these difficult, critical issues for shareholders and the company. Moreover, now that this is a rule, I ponder whether mandates like this one from the SEC push us in the right direction. Are we more informed? Do the right people have a greater say?

At XCEO, we provide guidance and support to our clients on the best practices which will improve shareowner value. We help our clients fulfill their responsibility to shareholders to improve their effectiveness, and we often remind them, that in moving toward enlightenment, these issues, although likely to be more and more frequent, may decrease in significance. As directors continue to move toward principled leadership in the boardroom, improve communication and provide value to shareholders, the need will be lessened.

The unintended consequences of this law are already being felt in companies large and small. Changing the methods in which companies communicate with shareholders is a good thing. I believe that maintenance of the status quo is for traditional boards and companies. However, as we continue to add mandate after mandate, the most important question we must ask ourselves is where will this lead? We clamor for great corporate governance because we believe that it adds value, and we clamor for increased access because we believe that this will improve long-term value for shareholders. Perhaps it will. However, before we ask for the next major change I strongly encourage us all to consider the impact of what we are really asking for. We need to remember to explore the issues, understanding that a snowflake at the top, can trickle down the organization and rapidly become a blizzard.

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About the Author

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As the Program Director of Corporate Governance & Board Leadership Development, Ms. Ronco led the development and release of XCEO's Online Extreme Personal Leadership Tools. Ms. Ronco also designed and created XCEO's Enlightened Corporate Governance Board & Director Evaluation Program intended for use in corporate boardrooms around the globe. A completely Web-based program with fifteen different on-line evaluation exercises, the program provides a reflective and creative evaluation process.

Ms. Ronco is a member of XCEO's research team in addition to being the principal publisher of the books *Corporate Rise* and *Compliance & Conviction*. For over six years, she has participated in many facets of the XCEO organization including idea creation, researching and editing.

Currently, Ms. Ronco is responsible for the development of, and oversight of XCEO's LinXsus Elite® and Premiere® Programs. These programs, intended for newly appointed directors or high-aspiration individuals seeking board service opportunities and support, serve as a lifeline for directors. This program includes XCEO's professional mentoring services, inclusion in XCEO's Search for Development program, an Individual Director Risk Module, as well as other personal brand concepts to provide a comprehensive experience to directors seeking improved boardroom effectiveness.

Prior to joining the XCEO team, Ms. Ronco worked for Morgan Stanley as a Financial Advisor and was Assistant Web Master for Santa Clara University's Leavey School of Business website.

Michelle earned her MBA with an emphasis on Finance and International Business from Santa Clara University in Santa Clara, California. She also holds a Bachelor of Science in Commerce (BSC) in Economics and Operations and Management Information Systems from Santa Clara University. She is on the board of directors of the Mexican American Community Services Agency (MACSA), and is a member of the National Society of Hispanic MBAs and National Association of Women MBAs.

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As part of XCEO's pursuit of enlightened corporate governance, we have created *the Enlightened Corporate Governance Board Performance Evaluation Program* to

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