

# CSUITE

## INSIGHT

TK Kerstetter's Boardroom Realities 10

Hitting the Mark on what Institutional Investors Look for in Proxies 17

### ASK THE EXPERTS

What Will Be the Hot Topics in Governance in 2014? 12

### FEATURE INTERVIEWS

Bonnie Hill 20

Stephen Miles & Taylor Griffin 24

Charles Elson 28

### LATEST RESEARCH

2014 Compensation & Governance Outlook Report 34

S&P 1500 Board Profile: Composition & Recruiting Trends Report 39

## GOVERNANCE

Adding Diversity to the Boardroom 6



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## Features

- 10 | BOARDROOM REALITIES**  
Could refreshing a company's board lead to increased shareholder value?  
*by TK Kerstetter*
- 12 | ASK THE EXPERTS**  
What do you think will be one of the hot topics in governance in 2014?
- 17 | CORPORATE GOVERNANCE: HITTING THE MARK ON WHAT INSTITUTIONAL INVESTORS LOOK FOR IN PROXY STATEMENTS**  
Shareholder engagement and feedback should drive changes to proxy statements to create more effective communication with investors.  
*by Ronald Schneider*



## COVER STORY



## 6

### ADDING DIVERSITY TO THE BOARDROOM

Experts across the spectrum agree that diversity in the boardroom is a good thing. So why is progress in this area taking so long?

*by Belen E. Gomez*



## Latest Research

- 34 | 2014 COMPENSATION & GOVERNANCE OUTLOOK REPORT**  
*Recent developments like the near default by the federal government and the confirmation of a new SEC chair could affect compensation efforts as focus on board decisions intensifies.*
- 39 | S&P 1500 BOARD PROFILE: COMPOSITION & RECRUITING TRENDS REPORT**  
*While board composition remained mostly consistent over the past five years, there have been some changes that track current recruiting and composition trends.*

## Departments

- 5 | LETTER FROM THE PUBLISHER**  
*Governance Trends*
- 44 | SEYMOUR CASH SETS THE TERMS**  
*Seymour likes his term limits just the way they are.*

## Feature Interviews

- 20 | BONNIE HILL  
THE HOME DEPOT**  
*"Shareholder engagement is one of the big issues for boards over the next several years."*
- 24 | STEPHEN MILES & TAYLOR GRIFFIN  
THE MILES GROUP**  
*"We are witnessing a move from the clubby and personally networked world of 20th century boards toward a situation where a board can function as a true, strategic resource for the CEO."*
- 28 | CHARLES ELSON  
JOHN L. WEINBERG CENTER FOR  
CORPORATE GOVERNANCE AT THE  
UNIVERSITY OF DELAWARE**  
*"I think the role of the academic will only continue to increase as the role of the board becomes more important."*



AS FEATURED IN

# The New York Times

SUNDAY, SEPTEMBER 22, 2013

## A Better Way to Compare C.E.O. Pay

By GRETCHEN MORGENSON

HOW much pay is too much pay? It's a question shareholders have been asking for years.

Now the Securities and Exchange Commission has dipped its toe into the executive pay pool with a rule issued last week that would require companies to publish a comparison of their chief executives' pay to the median compensation of most other company employees.

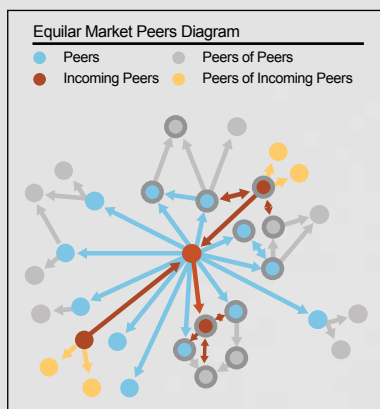
Unless you were born yesterday, you already know there's a vast gulf between C.E.O. pay and that of the public company rank and file. So the rule, if it goes into effect (it is now undergoing a 60-day comment period), won't be that revelatory. Sure, there will be noteworthy numbers. But the new rule will do little to help shareholders understand whether the executive pay awarded by their companies is appropriate and if not, how off the charts it is. A far more meaningful comparison for regulators is the peer groups public companies choose to use as benchmarks when setting their pay packages.

These peer groups, which are supposed to include similar companies, often don't. In many cases, companies choose peers that are far larger or more complex and whose executives are paid more to manage that size and complexity. Therefore, the inclusion of these companies in a peer group can skew an executive's pay higher. Investors have a name for such companies: aspirational peers.

Peer groups certainly are ubiquitous — in 2012, some 86 percent of companies in the Standard & Poor's 1,500-stock index said they used them, according to **Equilar**, the executive compensation analytics company in Redwood City, Calif. But they can be pretty blunt instruments for comparing executive pay.

Aware of the potential for questionable choices of companies within these peer groups, institutional investors are examining them more closely. **Equilar** has been assisting these investors with a system that generates a separate peer group for a company. Shareholders can use **Equilar**'s peer groups — and the pay they provide to their executives — to vet the groups chosen by their companies.

Aisha Mastagni, investment officer at the California State Teachers' Retirement System, says her organization uses **Equilar**'s peer groups as a gut check before voting on executive pay at companies. When wide disparities emerge between a company's peer group and the **Equilar** alternative, Calstrs officials have brought up the matter with company officials.



"The peer group aspect is one piece of the puzzle that we look at when we cast votes on company pay practices," Ms. Mastagni said in an interview last week. "Far too many companies use the peer groups as a starting point when they really need to be that reasonableness check."

Peer groups chosen by companies don't always differ significantly from those **Equilar**'s system produces. But many do.

ONE is Hain Celestial Group, a food company based on Long Island whose founder and chief executive, Irwin David Simon, received \$6.5 million in pay last year.

In its proxy statement, Hain discloses two different peer groups that it uses to benchmark pay. One consists of many food and beverage companies, including Chipotle Mexican Grill, Mead Johnson and United Natural Foods. Most have higher revenue than Hain's and half have larger market capitalizations. And yet Hain's chief executive received far more than the \$3.9 million median pay for the C.E.O.'s at those larger peers.

The other peer group used by Hain consists of companies whose founders, like Mr. Simon, still run the show. This peer group is made up of 14 companies, including Costco and Starbucks. The revenues of most of those companies were significantly higher than Hain's — Costco, for example, has \$99 billion in revenue compared to \$1.4 billion for Hain. Nevertheless, these peers paid their executives less — a median of \$4.8 million versus Hain's \$6.5 million.

**Equilar**'s suggested peer group for Hain, adds two companies to Hain's list, with median revenues that were much more in line: Post Holdings and SunOpta. This group paid their C.E.O.'s a median \$2.6 million last year, far less than what Mr. Simon at Hain received.

Mary Anthes, a spokeswoman for Hain, said that its peer group was selected by its board's

compensation committee and that for the last two years Hain's sales, earnings and stock price had been markedly higher, justifying the pay.

Kelly Services, the staffing company, provides another example. Its disclosed peer group has just two companies — ManpowerGroup and Robert Half International. Carl T. Camden, Kelly's chief executive, received \$3.3 million in pay last year. This sounds reasonable enough, given that the median pay received by the top executives at Kelly's peers was \$8.7 million.

But when you look at revenues, the peer group comparison makes less sense. Manpower's revenue was more than three times the \$5.5 billion Kelly generated last year, and the market capitalization of both peers was far in excess of Kelly's \$585 million.

As an alternative, **Equilar** chose a larger group — 14 companies, most of them in the employee staffing field — with median revenue of \$1.24 billion and market capitalization of \$775 million. In this case, **Equilar**'s more representative group was not so out of whack with Mr. Camden's actual pay. The median pay dispensed to the top executives at these companies was \$2.8 million, slightly below what Mr. Camden received.

Kelly Services did not respond to an e-mail seeking comment.


**Equilar** came up with the idea of creating alternative peer groups because its officials believed that in an age of big data, it could improve on the standard, more limited approach taken to come up with peer groups. Rather than just look at industry groups and revenues, **Equilar** builds relationship maps.

**Equilar** uses an algorithm to tap into peer group data found in S.E.C. filings and employ social media to generate what it contends are credible alternatives to company peer groups.

For example, **Equilar** consults all filings for mentions of peers and then matches them up. Say, for example, company A is identified as a peer by company B but A does not include B as one of its peers. **Equilar** feeds this information into its system. It also includes what it calls second-degree peers — when company A lists B as a peer and B lists company C as one, **Equilar** will consider adding company C.

**Equilar** maps these ties and identifies the strongest connections among them. The result is what it calls market peers for each company.

Investors have to weigh many elements when assessing the fairness of executive pay. Peer groups are just one of those, of course. But as the **Equilar** examples show, some peers are more equal than others.



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David has led Equilar from a pure start-up since its inception in 2000 to one of the most respected and trusted names in the executive compensation industry.

## GOVERNANCE TRENDS

**T**he upcoming proxy season brings with it change and complexity to how boards of directors operate currently and in the future. As we peer ahead into 2014, our latest issue of *C-SUITE Insight* explores a variety of evolving and emerging trends in corporate governance. We have included diverse viewpoints from board members, academics, consultants, and proxy solicitors to look at all sides of the major issues.

World-class leaders and experts provide their thoughts on topics that will be at the forefront of governance discussions in 2014. Bonnie Hill, lead director at The Home Depot and board member at Yum Brands, AK Steel, and California Water Service Group, shares anecdotes from her broad experience. Additionally, Professor Charles Elson, Director of the John L. Weinberg Center for Corporate Governance at the University of Delaware and board member at HealthSouth Corporation, provides his dual perspectives as director and scholar on the latest developments in governance. Stephen Miles and Taylor Griffin, both Principals at The Miles Group, offer views on CEO professional development, succession planning, and director education.

To expand the coverage of critical topics, “Ask the Experts” features leading governance professionals discussing what we can expect to see in the industry in the coming year. As usual, Seymour Cash has the last word with his unique thoughts on board tenure.

We are grateful to all our contributors for providing their thought leadership and insight. We appreciate your taking the time to read our latest issue. Don't forget to put our upcoming Executive Compensation Summit in San Diego on your calendar. We look forward to seeing you there. Please enjoy and feel free to contact me with your feedback. 



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FEATURE

**Adding**

**Diversity** to the

**Boardroom**

BY BELEN E. GOMEZ



# Outlook on Diversity in the Boardroom

In April 2013, the *University of Illinois Law Review* published “The Danger of Difference: Tensions in Directors’ Views of Corporate Board Diversity,” a study conducted by three academics from Duke University and the University of North Carolina. The study explored the pursuit of diversity by corporate boards as well as the impact of diversity on board performance. The results of more than 50 interviews with corporate board members underscored the ongoing debate regarding board diversity and shed light on the issues that may be hindering progress. Ultimately, the problem may stem from the fact that most directors “proclaim that diverse boards are good, but very few directors can articulate their reasons for this belief,” according to this latest research.

In this issue of *C-SUITE Insight*, we focus on a variety of critical issues that will be at the forefront of governance discussions in 2014, perhaps none more so than the topic of diversity in today’s boardrooms. This is far from an emerging topic in corporate governance. In fact, for several years,

governance experts, investors, regulators, and even company leaders themselves have agreed that diversity for diversity’s sake is good business. After pondering this argument, as well as the ambiguity regarding the effects of diversity on board performance, it is no longer a surprise as to why progress has been moving so slowly. Clearly, there are many sides to this issue that must be considered.

## LACK OF EVIDENCE

The lack of irrefutable evidence linking boardroom diversity to improved company performance is certainly an impediment to driving change. Though socially we have accepted pursuing diversity is a worthy effort, statistically we have yet to see conclusive results. For all the research that indicates a correlation between diversity and performance, as highlighted in the article “Think Tank on Boardroom Diversity” in *Corporate Board Member*, other research, the article notes, “refutes such claims or finds them to be unclear. For instance, a 2011 University of Michigan study examining the effect of the much-lauded Norwegian diversity quota...found that, post-quota, the 248 publicly listed companies in the study experienced ‘a large, negative impact...on firm value.’”

Likewise, the article highlights an “exhaustive” study conducted by Stanford University a few years ago, whereby the authors concluded that “the body of academic and regression analyses are, essentially, inconclusive.” Let’s also not forget the results of the study that opened this article, which showed board members seem to have difficulty explaining why and how diversity has had a positive impact in the boardroom.

With this level of uncertainty regarding how diversity improves board operations, there will consistently be challenges to changing the status quo. However, this lack of clarity does not negate the fact that diversity of thoughts, opinions, and experiences provide the *opportunity* for more insightful discussion and problem-solving. Thus, it is worth pursuing when also aligned with the expertise needed on the board.

## SLOW CHANGE PROMPTS CALLS FOR ACTION

Through the last decade, stakeholders have taken issue with the lack of diversity on public company boards and become more vocal in recent years about the need for change. An analysis of the numbers indicates an upward trend in diverse candidates elected to corporate boards. However, progress has no doubt been disappointing for strong advocates considering the increased efforts to address gender and minority gaps. As an example, in our recent 2014 Compensation and Governance Outlook Report, we found that in 2012, 15% of all S&P 1500 directors were women, compared to 13% in 2010. A 2 percentage point increase over three years leaves much to be desired in the way of progress.

We have seen this dissatisfaction played out publicly as social media giants Facebook and Twitter attempted to appease shareholders and governance critics by appointing one female board member in 2012 and 2013, respectively.



According to a recent article titled “More Women on Facebook, Twitter and Pinterest than Men,” 64% of Facebook users and 58% of Twitter users are female.

These numbers give proponents strong arguments for better representation of the user base. However, company leaders are clear that they are not resistant to diversity, only to diversity for diversity’s sake. In the cases of Facebook and Twitter,

the CEOs of both companies argue that having the right expertise on the board should take priority over box-checking for diversity, which divulges primary obstacles to increased board diversity—a lack of qualified diverse candidates and a check-the-box mentality.

At first glance, the diversity for diversity’s sake argument may seem like an effective motivator for companies to consider making changes to the composition of their boards. However, these very words may actually diminish the value that women and minorities bring to the table. Associating bringing a woman or a minority onto a board with the ability to check the proverbial diversity box is more destructive than valuable. It detracts from the fact that female and minority board members are just as qualified as their counterparts.

The greater issue may be that the supply of diverse candidates for boards to consider is simply too small. Typically, boards select exceptional candidates who are recognized as strong industry and executive leaders. These executives are believed to possess the experience and insight that is most attractive and valuable given boards’ current needs. The fact is that fewer women and minorities serve in these executive leadership positions, which most often serve as the stepping stone into the boardroom.

### QUOTAS AND TERM LIMITS

Diversity has emerged as a corporate governance hot-topic for both business and societal reasons, and thus, it has generated a host of potential solutions for regulators and companies to consider. Specifically, quotas and term limits are discussed frequently. Recent headlines in almost every major business publication draw attention to the fact that women and minorities are making progress in ascending to top executive positions. However, cracking the “glass ceiling” into the upper echelon of corporate America—the boardroom—has proven to be more difficult despite the increased attention on the issue.

The acute focus on companies like Facebook and Twitter will likely intensify and spread from the large-cap to the small-cap, especially as international governance practices are ahead of those in the U.S. in implementing formal policies to address board homogeneity. For example, mandated gender diversity quotas are

## FEWER WOMEN AND MINORITIES SERVE IN EXECUTIVE LEADERSHIP POSITIONS, WHICH MOST OFTEN SERVE AS THE STEPPING STONE INTO THE BOARDROOM.

already used in Norway, Spain, and France. The Netherlands, Belgium, and Italy are also considering instituting gender quotas. The long-term effectiveness of this nascent policy remains to be seen. However, quotas will no doubt continue to be a part of the diversity discussion in the U.S. as a means to prompt action.

Similarly, term limit policies are often discussed and debated as a solution to refresh boards and provide openings for new, diverse perspectives. Advocates for director term limits argue that without formal policies in place, incumbent directors will stay on boards, perhaps beyond a point where they continue to add value. Therefore, this leaves very few open seats at the table to nominate a diverse candidate.

### A LOOK FORWARD

There is no simple fix. The lack of diversity on corporate boards is not a problem easily fixed by one solution. Diversity is a sensitive topic at the business, cultural, and personal levels. Therefore, a blend and balance of solutions will likely be needed to close the lopsided percentages presented earlier. This actually begins in the executive ranks. Setting term limits or establishing quotas on their own likely will not be entirely effective if we don’t continue efforts to strengthen and augment the number of well-qualified, diverse candidates in the leadership pipeline.

Finally, directors must be able to articulate why diversity is valuable to the unique needs of their companies to drive change. Blanket statements trumpeting value are no longer sufficient. Without substance to support the belief in diversity, we will continue to go in circles in this debate, making only small percentage increases for years to come. ■

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For more information contact Ron Schneider at [ronald.m.schneider@rrd.com](mailto:ronald.m.schneider@rrd.com)

# Is it Time to Your Board?

*Renew,  
Refresh,  
Reconstitute,  
Rejuvenate,  
Revitalize,  
or maybe Regenerate.*



**R**egardless what the governance gurus are calling it these days, there is recent thought leadership that suggests boards give stronger consideration to increasing board turnover and ensuring their directors aren't stale, lack independence, and are keeping up with all the change, opportunities, and risks associated with today's fast-moving and globally digital world. Interestingly, this movement isn't just related to age but also one's tenure on the board. Let's look at the factors that are making board tenure an issue.

- We're seeing younger directors on public boards. Good examples include Clara Shih, who joined the Starbucks board at age 29, and Chelsea Clinton, who became a director of IAC/Interactive Corp. at age 31. These board members and others could serve for over 40 years.
- There is a popular phrase used by activist shareholders who say that boards are too *male*, *pale*, and *stale*. This is obviously a knock on certain boards' lack of diversity and independence.
- Turnover of board members has slowed down from a decade ago, and it's tough to renew a board when seats at the table aren't available.
- The number of board members who are retired is increasing, and board watchers wonder if longtime retired directors are aware of the digital and cyber opportunities and risks that are present today.
- Each year, PricewaterhouseCoopers' Annual Corporate Directors Survey asks board members if there are directors on their boards who should be replaced. Every year, the affirmative response hovers around 33%.

All of the above beg the questions:

- Is refreshing the board good for shareholder value?
- If the answer is yes, what is the best way to refresh the board?

In answering the first question, I end up asking myself the following: Is diversity of thought on a board a good thing? Is it good to have hard tenure rules when all companies and boards are unique and one size doesn't fit all? Is there a period of time when a board member who has retired from active business involvement falls behind emerging technologies that are changing our competitive environment? Is 20 years too long for a board member to serve on a company board? After answering these questions, I found it hard to argue that refreshing boards isn't a good thing for shareholder value. However, the key to a board's successful attempt at refreshing itself is its approach.



*TK Kerstetter is the chairman of Corporate Board Member and is a second generation pioneer of governance thought leadership and board education.*

## TERM LIMITS

In addressing the issue of how to refresh your board, let's look at how it's done today. Spencer Stuart's 2013 Board Index reports that 16 of the S&P 500 companies specify term limits in their corporate governance guidelines. Not a raving endorsement of term limits statistically, but companies and board leadership at those companies seem satisfied with the decision. While I think term limits have value to address the trends of younger directors joining boards, and I favor it over mandatory age retirement guidelines, shareholders want annual elections, and sitting directors are like Congress when discussing term limits. We think it's a great idea until it actually affects us.

The most popular solution to refreshing boards today is a mandatory retirement age for directors. Spencer Stuart's Board Index says that 72% of the S&P 500 have established this governance guideline. These numbers suggest that this is the favored method for promoting board turnover, but I suspect that exceptions are often made for primo directors who continue to be of high value to company boards. I find this to be a weak substitute to evaluate directors on their true contribution and consider it an easy way out of any confrontation among directors.

That leaves board evaluations for us to address as a solution to refreshing boards. Within the S&P 500, 98% of companies report conducting some form of board evaluation. The key here is "some form." Too few use their board evaluations to truly evaluate board and director performance and subsequently use that feedback to remove non-performing directors. There is no question in my mind that this is the most logical method to refresh boards. This is when directors in leadership positions earn their extra pay for serving as independent chairmen, lead directors, or chairs of the Nominating and Governance Committee. In Part 2 of this *Boardroom Realities* feature (next issue), we'll take a hard look at the who, what, and how of using board evaluations to refresh your board and address board tenure. **C**

A silhouette of a man in a suit stands in the center, facing right. He is positioned between two large, stylized compasses that are part of a larger, abstract design. The background is a warm, yellow-orange gradient. The compasses have red and green markings and are set against a pattern of small, white dots. The overall composition suggests a theme of navigation, direction, and expertise.

## ASK THE EXPERTS

What do you think will be one of the hot topics in governance in 2014?



## Donna Dabney

The Conference Board

Executive Director, Governance Center



The Conference Board provides research and convenes the world's leading organizations to improve their performance and better serve society. The following key corporate governance issues have emerged from our work in 2013:

**1.** Rising income inequality and a belief that the system is rigged in favor of the powerful is undermining the capitalist system as we know it. The corporate engine that has driven our economic prosperity may be altered in ways that are damaging to economic growth and innovation if business leaders do not take responsibility for restoring trust in business.

**2.** Executive compensation will continue to draw public scrutiny and legislative attention because it is entangled with the principal political issue of the times—how to address increasing degrees of income and wealth inequality.

**3.** What is the optimal balance of power between directors and institutional investors in the governance of public companies? Today, there is a real possibility that directors may not be re-elected if they do not implement an advisory shareholder proposal, even if the proposal does not receive the support of a majority shares outstanding. How should directors manage their fiduciary duties to the company and to all of the company's investors in this circumstance?

**4.** We expect activist hedge funds will continue to seek seats on public company boards to influence strategic direction and/or to advocate for financial restructuring to increase returns to shareholders. Directors will increasingly be called upon to balance demands for short-term results against the long-term sustainability of the enterprise.

Donna Dabney joined The Conference Board as executive director of the Governance Center in August 2012. In her current position, Dabney leads the efforts of The Conference Board in the area of corporate governance.

Prior to joining The Conference Board, Dabney was vice president, corporate secretary, and corporate governance counsel of Alcoa Inc. Dabney has extensive experience in corporate governance matters, having served as a member of management for over 15 years on the boards of Alcoa and Reynolds Metals Company. She is a recognized expert on governance issues related to executive compensation. At Reynolds she was a member of the senior management team with oversight responsibility for the global operations of the company and served as chief mergers and acquisitions counsel and secretary to the board of directors. When Alcoa acquired Reynolds in 2000, she joined Alcoa as its secretary, assistant general counsel, and group counsel of the Consumer, Packaging, Distribution, and Construction Group, where she was part of a three-member team with oversight management responsibility for this business. As part of her work with the Alcoa board of directors, Donna has gained substantial experience with sustainable development in the Amazon region of Brazil.

Before joining Reynolds, she practiced law with the Richmond, Virginia, firm of McGuireWoods LLP and served on the faculty of Old Dominion University. She is a 1980 graduate of the University of Virginia School of Law and a member of the Order of the Coif legal honorary society. Dabney is a member of the board of directors of American Forests, the New York advisory board of the Society of Corporate Secretaries and Governance Professionals, and a member of the faculty of the Citadel Directors Institute and of the Practising Law Institute.

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**Charlie Tharp**

Center On Executive Compensation  
Co-Chief Executive Officer



In 2014, a hot topic for compensation committees will be the continued emphasis on effectively, crisply, and clearly communicating the pay for performance story. There has been much experimentation over the last two years in providing supplemental compensation tables and graphs to better explain how compensation is related to financial performance

and total shareholder return. In view of greater interest by investors in pay for performance assessments when determining Say on Pay votes, companies have increased their disclosures of both Realizable and Realized Pay. This is due in part to companies being dissatisfied with the Summary Compensation Table measure of pay as appropriate for assessing the pay for performance linkage and in part to the usefulness of supplemental disclosures in more clearly telling the pay for performance story. Using supplemental disclosures also helps to enhance shareholder engagement and counter-balance the influence of proxy advisory firms. In 2014, compensation committees will continue to refine their approach to telling the pay for performance story. I also expect there will be a greater convergence of the definitions and formats used for presenting supplemental pay disclosures.

This increased focus on clearly demonstrating pay for performance will become even more important as the SEC releases proposed rules implementing section 953(a) of the Dodd-Frank Act, which mandates the disclosure of the relationship between compensation actually paid and company performance.

**Charlie Tharp** is the Co-Chief Executive Officer of the Center On Executive Compensation. In that role, Tharp is responsible for setting overall policy positions and research initiatives undertaken by the Center and representing the Center in public forums. He is also Executive Vice President of HR Policy Association.

Tharp has over 25 years of corporate experience, including key human resource positions with General Electric, PepsiCo, Pillsbury, CIGNA, and Bristol-Myers Squibb, where he served as Senior Vice President of Human Resources. Tharp also served as the interim Executive Vice President of Human Resources for Saks, Incorporated. Earlier in his career he served as an executive compensation consultant for the global consulting firm of Towers Perrin.

Tharp holds a Ph.D. in Labor and Industrial Relations from Michigan State University, a J.D. from the Quinnipiac School of Law, a Master's in Economics from Wayne State University, and a B.A. from Hope College, where he was Phi Beta Kappa and a Baker Scholar. In 1998 Tharp was elected a Fellow of the National Academy of Human Resources and in 2010 was elected a Distinguished Fellow of the Academy, the highest honor in the HR profession. He previously served as President of the Academy. He currently serves on the Board of Advisors of the Drexel University LeBow School of Business Center for Corporate Governance.





**Rhonda Brauer**  
Georgeson Inc.  
Senior Managing Director – Corporate Governance



“Focus on Directors” will be a hot governance topic in 2014. With majority voting for director elections becoming more widespread in the U.S., investors, management, and directors will be more focused on whether directors get a majority of the votes cast for them and, if so, by how high a percentage.

In 2013, directors stepped down from the HP and JPMorgan Chase boards likely due to weaker investor support: They received more than a majority, but still less than 60 percent.

Another focus will be on whether boards have the right skills and experience mix. Investors look to see if, as a group, directors can ask the right questions of management and each other to avoid a company meltdown or major misstep. Gender and racial diversity have become increasingly important, as investors want qualified women and persons of color as directors, to contribute differing perspectives. Diverse directors can be most effective not as solitary race or gender representatives. Having two or more can often help them contribute in a more meaningful way, as well as pave the way for further diversity in corporate America.

Finally, directors will be increasingly involved in direct engagement with investors and the proxy advisory firms. When a company issue rises to a great level of importance or sensitivity, directors are often best positioned to explain how the related decisions were made in a thoughtful and well-informed manner, for the company’s best long-term interests. Direct engagement also gives directors the opportunity to hear important unfiltered feedback about company decisions.

**Rhonda L. Brauer** is a Senior Managing Director – Corporate Governance at Georgeson, the proxy solicitation firm, which she joined in May 2008. She focuses on helping companies to enhance communications with their shareholders and third-party opinion-makers and to analyze their governance practices in light of the current corporate governance landscape and their own business developments. She also advises management teams and boards on ongoing corporate governance developments and conducts board self-assessments. In addition, Rhonda works with clients to help them obtain their desired shareholder votes on director elections, proxy contests, shareholder proposals, equity compensation plans, and other corporate governance matters.

Prior to joining Georgeson, Rhonda held a variety of positions over 15 years in the Legal Department of The New York Times Company, most recently serving as Secretary and Corporate Governance Officer and as a member of the Company’s Senior Management Team. Her most recent responsibilities included providing key support to senior management and the board on the development and implementation of appropriate corporate governance practices (including, among other things, conducting effective board self-assessments) and on strategic communications with institutional shareholders, investor publications, corporate governance rating firms, and other relevant opinion-makers. She helped to lead the internal team that coordinated the Company’s response to a dissident’s withhold-the-vote campaign in 2007 and a threatened 2008 proxy fight, which eventually settled. Rhonda also provided legal and other advice to The New York Times Company Foundation and The New York Times Neediest Cases Fund. Previously, she was responsible for legal advice on, among other things, disclosure and insider trading issues, and securities, treasury, and transactional work.

Rhonda has a J.D. degree, magna cum laude and Order of the Coif, from Indiana University School of Law (Bloomington, IN) and an A.B. degree, magna cum laude and Phi Beta Kappa, from Cornell University’s College of Arts and Sciences (Ithaca, NY).

**Georgeson**

**Jeffrey Powell**

Diligent Board Member Services  
Executive Vice President



The modern office is now one without walls, making the control and oversight of sensitive company information more important than ever. Historically, organizations have relied on internal email and file sharing solutions to allow employees to review documents. Now, they must be able to access these materials anywhere at any time. With the update of

BYOD, Gmail, and Dropbox, gone is the assurance that this information stays within the confines of company-owned devices and servers.

In recent years, secure board portals have become the gold standard for how companies communicate with their board of directors. But why stop there? In 2014, expect to see companies adopt the solution for use outside the boardroom by leadership teams. The convergence of mobility and accessibility, coupled with strengthened security and complete user control, is a powerful combination that can enable enhanced collaboration and more informed decision-making.

Jeffrey Powell serves as Diligent Board Member Services' Executive Vice President of Sales, where he is responsible for the development and execution of client acquisition strategies throughout the Americas. Throughout his five years with Diligent, Jeffrey has advised thousands of companies across industries including banking, energy, higher education, and health care on how secure, electronic access to board materials can improve organizational effectiveness and governance.

In addition to more than 15 years of sales experience, Jeffrey also worked for 12 years as a founder, board member, and officer of a commercial translation agency. This deep familiarity with both the sales and executive management of growing organizations has enabled him to become expert in critical governance issues. Jeffrey frequently contributes thought leadership and appears at both governance-related and vertical market events to discuss board portal adoption and implementation best practices. He is also a member of both the Society of Corporate Secretaries and Governance Professionals and the Canadian Society of Corporate Secretaries.

**Jamie Tassa**

NYSE Governance Services  
Senior Vice President, Events



The symbiotic relationship between boards and investors is extremely important to the effective functioning of public companies in the financial marketplace. To that end, shareholder engagement will continue to be a hot governance topic in 2014. In almost every session at our board education programs in 2013, regardless of the overarching topic,

transparency and best practices for communicating to institutional investors came up as a challenge and opportunity for boards. Different shareholders bring diverse investment parameters, performance expectations, and perspectives on governance practices. Boards are grappling with the who, what, when, and how of engaging shareholders and are looking for guidance on investors' expectations.

Jamie Tassa is Senior Vice President, Events for NYSE Governance Services. She is responsible for the strategy of NYSE Governance Services' events and the development and management of all Corporate Board Member programs. Her functional portfolio includes the development of event agendas, speaker recruitment, and overseeing marketing strategy and branding for all conferences. In addition, she works with the company's sales staff in selling event sponsorships and managing sponsorship deliverables. Prior to working at Corporate Board Member, she was founding editor of *Southeast Innovations*, an online newsletter for venture capital firms covering emerging technology companies throughout the Southeast, and a public relations specialist at Abovo Marketing Group in Atlanta, Georgia, working with emerging technology companies. Ms. Tassa received her Bachelor of Arts in Journalism with a focus in public relations from the University of Georgia.

**NYSE GOVERNANCE SERVICES**  
CORPORATE BOARD MEMBER®

# CORPORATE GOVERNANCE



Hitting the Mark on what Institutional

Investors Look for in Proxy Statements

**A**s we approach the 2014 proxy season, once again issuer proxy disclosures will be put to the test. Will company compensation and other corporate governance practices receive the necessary support? Will director nominees, viewed as ultimately accountable to shareholders for management's actions, be supported? Will investors understand management's vision and strategies sufficiently to enable them to support the company despite the inevitable short-term performance issues or negative proxy advisor recommendations?

How clearly company management and boards communicate their corporate governance and executive compensation practices and rationale through their proxy statements (along with year-round investor engagement on these issues) will help answer these questions. Catalyzed by the 2011 advent of mandatory Say on Pay proposals for most companies, an increasing number of companies are transforming their proxies from an SEC compliance document (SEC form 14a) to an effective communications piece.

RR Donnelley assists more than 1,900 U.S. companies with various phases of proxy statement design, production, filing, and distribution. This affords us a unique vantage point to

see the different ways companies approach this communications challenge, their rationale, and results.

In 2011, we witnessed significant innovation in proxy disclosure, when a number of mostly large-cap companies incorporated “proxy summaries” at the front of their documents. They also provided greater detail about their boards, including director skills matrices, as well as more graphical representations of compensation structures and pay for performance alignment. Since then, many of these large-cap companies’ peers and some smaller companies began emulating the leaders in this arena.

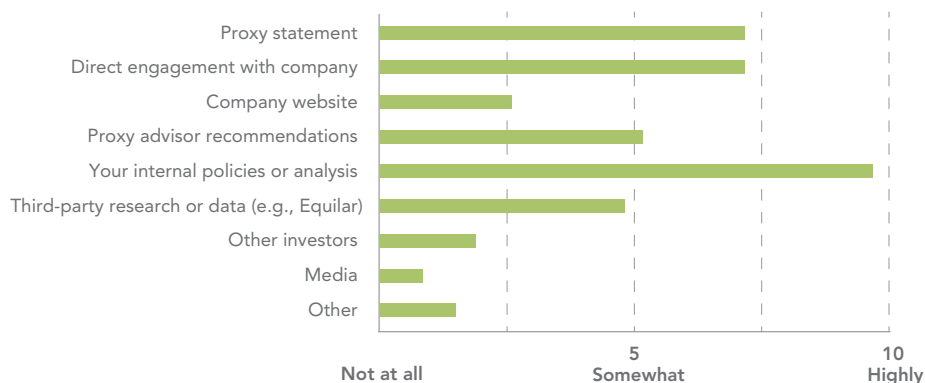
## ENGAGEMENT AND INSIGHT SHOULD DRIVE DESIGN

In discussing goals for their proxies, we have noticed that a handful of companies remain committed to innovating and staying in the vanguard of proxy disclosure, while most companies are more concerned about not appearing to be laggards, particularly in the eyes of their investors. Companies must recognize that if their peers are improving the visual appeal and clarity of content of their proxies, investors are making comparisons. Therefore, companies must either keep pace or risk falling behind.

But emulation without insight into why companies do what they do may miss the mark. Some ways our more innovative clients have described their proxy-disclosure processes to us include:

- Proactive investor engagement about governance and compensation issues and how to disclose that information

Chart 1 Describe how the following information sources influence your voting



- Using the insights gained and identified investor informational needs, improve the clarity of the proxy content
- Adjusting the format and navigation to ensure that key content is easily found (or hard to miss)
- Using available voting and anecdotal feedback from investors and other constituents on these enhanced disclosures, incrementally adjust the proxy each year (i.e., “rinse, repeat”)

In other words, engagement and feedback drive changes to content, and design and navigational features draw the reader to key content. Many companies have not yet engaged with their investors on these issues. Others that have engaged with their investors report investor responses such as “we’re fine...no issues at this time...we’ll call you.” While this type of response is possibly comforting, it provides no actionable insight.

To assist issuers with remaining at the forefront of proxy disclosure, RR Donnelley’s Proxy Solutions Group recently conducted an engagement process, by surveying institutional investors about proxy statements. We asked a broad range of investors what matters most in terms of content, format, and design when making their voting decisions. We also asked how proxies could be improved to make these company disclosures a more useful and primary influence for investors in making voting decisions relative to proxy advisor reports.



*Ronald Schneider is the Director of Corporate Governance Services at RR Donnelley. Over the past three decades, Ron has advised public companies of all sizes, industries, and stages of growth facing investor activism, as well as challenging and sensitive proxy solicitations involving corporate governance, compensation, and control issues.*



## KEY SURVEY RESULTS

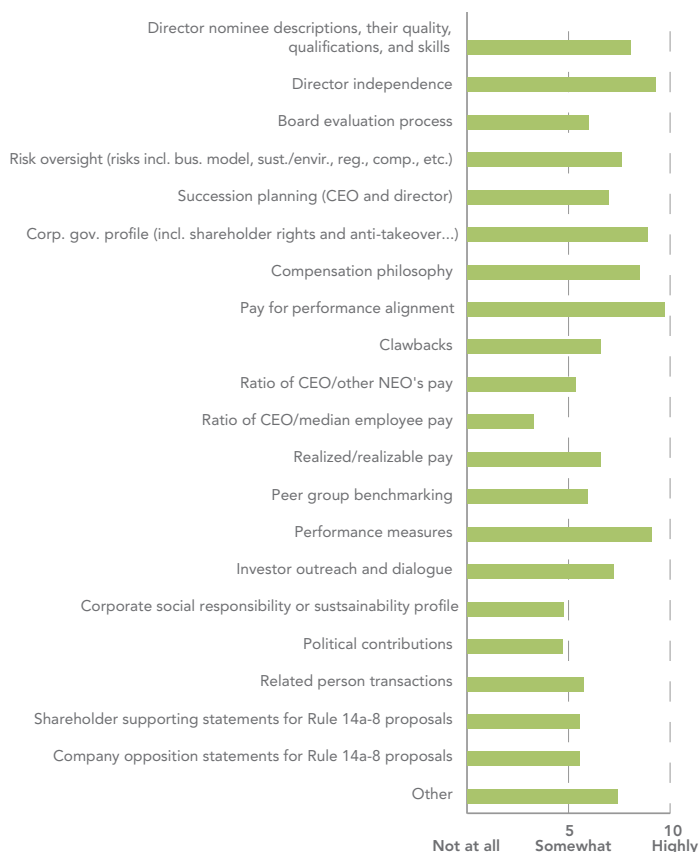
- A.** Most responding investors indicate their votes are primarily driven by, in order of importance:
1. Their own internal policies
  2. Company disclosures (proxy statement and direct engagement)
  3. Third-party analyses and recommendations (proxy advisor recommendations, Equilar data)
- B.** The first destination within the proxy for most investors is the CD&A or its Executive Summary (CD&A)—Proxy Summaries are also read
- C.** The top three topics investors are interested in are:
1. Director independence
  2. Performance measures
  3. Pay for performance alignment

Of these three topics, investors are relatively satisfied with the current quality of director disclosure, but less so with compensation-related disclosures. Naturally, some investor responses are subject to interpretation. Others provide clear guidance for the ways that companies should enhance their disclosures and are guiding us in working with our clients to improve the quality and utility of their proxy statements.

Will the 2014 proxy season be more or less contentious than proxy seasons from prior years and what will be the results? In 2014, companies may not be able to inoculate themselves from activist initiatives. However, they can control how well they prepare and respond in terms of enhanced clarity of their proxy disclosures. Effective proxy communications can shape and influence the votes of long-term, mainstream investors, whose support activists require in order for most of their initiatives to succeed.

For a copy of the RR Donnelley Institutional Investor Survey, please contact Ronald Schneider at [ronald.m.schneider@rrd.com](mailto:ronald.m.schneider@rrd.com).

**Chart 2 To what extent do the following provide important content for making voting decisions (whether presently SEC-required or optional)?**



**Chart 3 On average, how clearly and effectively are these topics disclosed?**



## INTERVIEW WITH **BONNIE HILL**



**B**onnie Hill is President of B. Hill Enterprises, LLC, a consulting firm focusing on corporate governance and board organizational and public policy issues. She has a wide-ranging career in business, government, education, and philanthropy. Her experience includes over 20 years in corporate governance serving on a number of corporate boards that currently include The Home Depot, where she serves as lead director, Yum Brands, Inc., AK Steel Holding Corp., and California Water Service Group. She is also on the boards of the RAND Corporation and the Lead Directors Network (Founding Member). She was recognized by the NACD Directorship as one of America's most influential people in Corporate Governance in 2010 and as a 2011 Outstanding Director by the Financial Times' Outstanding Director Exchange.

Dr. Hill served on the board of FINRA (Financial Industrial Regulatory Authority) Investor Education Foundation and was a member of PCAOB (Public Company Accounting Oversight Board) Investor Advisory Group. She served as President and CEO of The Times Mirror Foundation and Senior Vice President of Communications and Public Affairs at the *Los Angeles Times*. Her other experience includes serving as Dean of the McIntire School of Commerce at the University of Virginia, co-founder of Icon Blue, Inc., a brand-marketing company, and presidential appointments in the Ronald Reagan and George H.W. Bush administrations. She has chaired the Consumer Affairs Advisory Committee for the SEC and served on the board of directors of NASD Regulation, Inc. Prior to working in Washington, D.C., Dr. Hill was a Vice President with Kaiser Aluminum and Chemical Corporation.

She has a bachelor's degree in psychology from Mills College, a master's degree in educational psychology from California State University, Hayward, and a doctorate in education from the University of California, Berkeley, and numerous awards and recognitions.

# “IT IS IMPORTANT THAT ALL DIRECTORS ARE ENGAGED TO THE FULLEST EXTENT POSSIBLE.”

**C-Suite Insight:** The theme for this issue is Governance Outlook. We would like to get your thoughts on what you think will be some of the major topics of discussion in 2014 for corporate boards.

**Hill:** The issues that will continue to be top of mind for boards and shareholders are not new. We will continue to focus on pay for performance, board independence and diversity, risk management, and shareholder rights to name a few. There is also a growing concern about cyber security and social media, particularly in an environment where a company's reputation can be damaged with just the stroke of a key. Another interesting topic that is getting a bit of attention is term limits for directors.

**CSI:** Looking back, what are some of the topics or issues that you thought would be a big deal but turned out to be a flash in the pan, and are there any changes that have surprised you?

**Hill:** I can't pinpoint any particular issues, however, during the past couple of decades I have seen subtle changes in boardrooms. Perhaps the greatest change has been much more engagement of directors. There is more intense focus on risk in all areas, including financial risk, operational risk, manufacturing risk, and any behavior or actions within compensation that could encourage unnecessary risk. Another change is an expectation that directors will engage in discussions with shareholders, generally in an effort to resolve shareholder concerns before they become major problems. I find this refreshing.

**CSI:** How has the governance landscape changed since you've been a director?

**Hill:** A number of changes have taken place, some for the better and some still questionable. There are fewer staggered boards, most directors are now elected annually, there are fewer CEOs on each board, mostly as a result of the limited number

of boards on which CEOs can serve, executive sessions of the independent directors are now commonplace, and of course, the requirement that the compensation committee be comprised solely of independent directors. In addition, there seems to be a growing willingness on the part of directors to meet with shareholders, and shareholder advocates, something that was extremely rare when I began board service over 20 years ago. These are just a few of the noticeable changes.

Post Sarbanes-Oxley, as directors we were spending an exorbitant amount of time on process, making certain that we were completely compliant with the new law. At one point we were spending more time on compliance than on the business. During this time, we saw the evolution of a number of Director Education Programs, including director certification programs with the objective of continuing education for sitting directors, and preparing aspiring directors for the role they hope to undertake.

**CSI:** What's your view on the role of lead director? What are some of the tough challenges and situations in that role?

**Hill:** The lead director has evolved as an important role on many boards. It is a role that requires collaboration and inclusion. It is important that all directors are engaged to the fullest extent possible in the deliberations of the board. Among the challenges is ensuring that the board not defer to the lead director for important decisions. The lead director should champion director evaluation, and in those rare instances that a director is not fulfilling his or her obligations, be able to have the tough discussion with the individual(s).

When I began board service in 1991, there were no lead directors on any of my boards. My first experience with the role was at Home Depot. When I joined the board in 1999, Ken Langone was the lead director. As such, he held executive sessions with the independent directors before they became more or less mandated. He was an excellent lead director. He was passionate about the company, tough on the business side, and known by many associates as a compassionate and caring individual. He was considerate of the board as a whole, recognizing that we all had the same obligations, duties, and

liability. He began every executive session with a question, "What's on your mind?" Today, a strong lead director can make the difference between calls to separate the Chairman and CEO, or acceptance of the combined roles.

The ideal lead director has a way of facilitating ease of communications between the Chairman and CEO and the rest of the board, ensuring that the CEO does not spend an inordinate amount of time responding to every director on every issue. The lead director should be someone who can present the board's position to the CEO and help structure meetings efficiently, ensuring adequate time for full discussion on critical issues.

I'm very fortunate to have been lead director at Home Depot where we have an outstanding board, a board that understands the role of lead director and uses it well. We have a Chairman and CEO who doesn't hesitate to pick up the phone and call me or send me a note if there's something on his mind that he'd like to discuss. There are also times that he may need to speak directly to other directors. It is important to note that the lead director is not a barrier between the CEO and other directors. The challenge is to remember that all directors are equally responsible to shareholders.

**CSI:** What are your thoughts on board retirement policies and how they relate to term limits and this mandatory retirement age that boards seem to have set?

**Hill:** The mandatory retirement age is probably a good thing in the sense that it forces transition. Some companies have given themselves enough flexibility that if they want a director who has reached the retirement age to continue on beyond retirement, they can put that director up for reelection as needed. Board service is not an entitlement, directors are elected by the shareholders, and shareholders expect that the board will abide by their bylaws and governance guidelines.

Furthermore, when we look at the issues we talked about earlier with regard to cyber security, social media, and social networks, electing new directors who understand the tech world is important. There should be a balance between the long-term and new directors, so that a board always has balance. Every board should make the decision whether to use term limits or mandatory retirement age based on its unique needs. There is no one size that fits all.

**CSI:** Can you expand a little bit more on the topic of term limits? What are the implications that perhaps a long term has on independence? Does



it compromise independence at any point in time?

**Hill:** I know many individuals who have been on boards for 10, 12, 15, or more years, and they are more, not less, independent. They understand the business and know the company well. These directors ask the most probing questions and have the benefit of past experience, and they are relentless. So my experience has been that the long-term directors have been some of the most valuable directors for shareholders. Boards need to evaluate their directors each year and make decisions on the nominees based on value-added, not the number of years a director has served.

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**CSI:** In regard to CEO succession, what are some of the best practices for companies today?

**Hill:** The selection of the CEO is the most important decision a board will make. Succession planning is a continuous process, not only for the CEO but also for the leadership team. There should always be a process by which the board is evaluating the CEO, along with successor candidates within the company. The best of all worlds is a homegrown CEO, whenever possible. It doesn't always happen, but when it does, it tends to keep the company's culture in a steady state.

## “LONG-TERM DIRECTORS HAVE BEEN SOME OF THE **MOST VALUABLE** DIRECTORS FOR SHAREHOLDERS.”

The board needs to completely understand the skill sets, the leadership style, and ethical principles that it is looking for in the CEO. There are times the board has to look outside, but not until it has been determined that the leader they need is not within the ranks. The board also should evaluate the CEO on the basis of the bench strength that he or she has developed, and at least once a year go through in-depth succession planning with the CEO. The board should also be familiar with the entire senior management team, having seen them both in and out of the boardroom.

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**CSI:** Going forward, what should boards be focused on in the next five to 10 years?

**Hill:** Shareholder engagement is one of the big issues for boards over the next several years. It is my belief that boards need to have this discussion in the boardroom. Today, more than ever, there is an expectation that directors will be more accessible to shareholders. How, and under what

circumstances that engagement should take place is still in question. We're hearing from major shareholders that they would like to have more engagement with members of the board of those companies in which they invest. In most instances, the engagements should be with the understanding, advice, and coordination with management. In all circumstances the engagement must be in compliance with Regulation FD. As directors, we should be transparent to the extent that we can within the confines of the law.

Succession planning will continue to be a major issue for boards, not just for the next several years, but on a continuing basis. Boards must always be focused on succession planning for the CEO, directors, and the C-Suite. In as much as cyber security and social media continue to serve as significant risks to companies, boards must ensure that they have the expertise on the management team, as well as on the board, to understand and mitigate these risks to the extent possible. ■

## INTERVIEW WITH **STEPHEN MILES** AND **TAYLOR GRIFFIN**



**S**tephen Miles is the founder and Chief Executive Officer of The Miles Group. Previously, he was a vice chairman at Heidrick & Struggles and ran Leadership Advisory Services. With more than 15 years of experience in assessment, executive coaching, top-level succession planning, organizational effectiveness, and strategy consulting, Stephen specializes in CEO succession and has partnered with numerous boards of global Fortune 500 companies to ensure that a successful leadership selection and transition occurs.

Stephen is a recognized expert on the role of the chief operating officer, and has consulted numerous companies on the establishment and the effectiveness of the position and supporting the transition from COO to effective CEO. He is a coach to many CEOs and COOs around the world, and his clients cut across all industry sectors.

He is an advisory board member at The Pythian Group, as well as a member of Big Think's Delphi Fellows program. He holds a bachelor's degree in psychology and a master's of business administration, both from Queen's University in Kingston, Canada. He also holds a master's degree in psychology from the University of Victoria.



**T**aylor Griffin is a Partner and Chief Operating Officer of The Miles Group. Her client work focuses on succession, executive assessment, executive coaching, board effectiveness, and top team effectiveness services. As COO, she is responsible for the day-to-day administration of the firm. Prior to joining The Miles Group, she was an associate principal with Heidrick & Struggles' Leadership Consulting Practice.

Taylor has significant experience across a wide range of leadership advisory services, including executive coaching, executive assessments (including pre-hire or pre-invest assessments), top team development work, board evaluations, and CEO succession planning, in addition to consulting on talent management, team effectiveness, and organization structure and change. She has worked on numerous CEO succession projects around the world, partnering with clients to ensure that a successful leadership selection and transition occurs. She has also worked on chairman successions and board effectiveness reviews, partnering with the board of directors to help them with their overall effectiveness, committee effectiveness and individual director effectiveness.

Before joining Heidrick & Struggles, Taylor was an attorney specializing in commercial litigation and bankruptcy matters in state and federal court. Taylor holds a bachelor's degree in political science, cum laude and with honors, from the University of Arizona, and a juris doctorate from Emory University School of Law, where she served as an editor of the *Bankruptcy Developments Journal*.



**C-Suite Insight:** Let's start the discussion by providing readers insight into The Miles Group.

**Stephen Miles:** The work we do at The Miles Group is about adding value where it matters most in an organization—its people. We help companies bring highly strategic thinking and execution to their talent needs across both their current and future generations of leadership. Specifically, we create strategies around high performance, ranging from executive assessment and coaching to succession planning for the C-Suite and boards to effectiveness training for CEOs, directors, and the company's top team. We have also translated our experience working with thousands of upper-level executives into customized education content designed for a broader group of leaders, those executives who are coming up through the organization.

When a company comes to us for help, there might be a certain event that triggers the call, such as a pressing need to develop a succession plan or an executive transition that needs support. But really, most of the work we do is about taking an already well-functioning organization to a much higher level of performance.

**Taylor Griffin:** With the CEOs and boards we work with, they want to know, "How can we optimize the talent we have?" The top team may have processes that have worked in the past, but they may need that "shot in the arm" to really amp up for the future. They want fresh thinking

and an outside perspective—and they want to know what kinds of things are working in the best organizations around the world.

We have been able to see in real, practical terms what works and what doesn't when it comes to a host of areas—from board interface to management structure to talent development to succession processes. We can then provide our clients with a wealth of expertise around these issues and show them how to implement changes in a very pragmatic way.

**CSI:** The theme for this issue of C-SUITE Insight is Governance Outlook. From your perspectives, what are your thoughts on the governance topics that will drive discussion in 2014?

**Miles:** Succession is a hot-button issue already and will continue to get hotter. There is both a push from the outside to address this issue as well as a real interest from inside boards to make sure that they are implementing best practice. Boards themselves are recognizing the strategic imperative to get serious about succession planning—for both the CEO and the directors themselves.

The topic of performance evaluations is one that will get increasing airtime in 2014. Boards are engaging us more and more to facilitate in this area as they move beyond a check-the-box, compliance-based approach to a more meaningful exercise tied to strategy. Boards are really pushing

## "BOARDS ARE REALLY PUSHING CEOs TO FURTHER DEVELOP THE COMPANY'S TOP TALENT"

—Stephen Miles

CEOs to further develop the company's top talent. In a board survey we conducted with Stanford, directors cited mentoring skills as one of the top weaknesses of their CEO.

**Griffin:** In the same survey, it's also interesting that tied with mentoring as a top weakness was the area of board engagement. Boards take extremely seriously their relationship with the CEO, and CEOs must step up in this area in order to be effective in communicating around the strategic direction of the company.

Boards are also building stronger processes around evaluating themselves and individual director performance—again, getting away from a check-the-box approach to one that measures how directors deliver against the needs of the company.

Other topics that will see even more discussion and debate in 2014 are the areas of board leadership structure, board declassification, regulatory challenges, and, as always, the issue of compensation.

# “SUCCESSION PLANNING NEEDS TO BE DONE IN A **PROACTIVE AND DELIBERATE MANNER** IN ORDER TO AVOID UNPLANNED FIREFIGHTS AND THE ASSOCIATED DISASTROUS OUTCOMES.”

—Taylor Griffin

**CSI:** In one of your latest publications you identify 11 key challenges for CEOs in 2014. What are some of the challenges and how should CEOs and boards try to tackle them?

**Miles:** CEO/board engagement is the most important relationship of the entire enterprise. We are witnessing a move from the clubby and personally networked world of 20th century boards toward a situation where a board can function as a true, strategic resource for the CEO. Also, as boards evolve and refresh their own talent, CEOs must adapt to new personalities, capabilities, and levels of knowledge about the business.

**CSI:** In some of your research, recently in partnership with Stanford University, you found that two thirds of CEOs don't receive any outside advice on leadership abilities, though most would welcome the opportunity to work with a coach. What does this indicate about the relationship with the board and the perception of having a coach?

**Miles:** There is still some residual stigma among directors—and CEOs—that coaching is somehow “remedial,” that it’s all about fixing something that’s wrong. But, in fact, real coaching is about enhancing high performance, similar to how elite athletes use a coach to continually improve their game.

We are beginning to see a wider recognition among boards and executives of the immense value of coaching, and a greater demand for this on all sides. The best CEOs are ones who consume insight from many different directions, both inside the firm and outside the firm. They use external coaches as an important source of fresh thinking, to help them approach a problem from a whole new perspective.

**Griffin:** Critical to the CEO's relationship with the board, however, is how he or she presents the idea of coaching, and the progress one is making, to the board. Some board members grew up in an era when coaching was truly remedial and not

something a CEO would ever voluntarily engage in. So there is an element of education that must happen – teaching the board what coaching really means today, and how the organization can benefit from it.

**CSI:** What are some global best practices in the succession process and what are some of the more case-by-case issues you have seen arise?

**Miles:** We have conducted many successions for companies worldwide, and have been able to see very powerfully the practices that lead to effective transitions. Interestingly, while boards have historically brought in advisors for a number of important areas they govern, from audit to compensation to risk, they have not generally had advisors in what is arguably their most important role, CEO succession. Now, we are seeing more and more boards retaining advisors to support them through the succession process.

One of the most important starting points for CEO succession planning is to view succession as a multi-person event. Selecting a CEO needs to be made in the context of the strength of the top management team, the state of the company, the external environment, and whether there are other structural moves that can be made to eliminate some risk. The whole system around and including the CEO must be evaluated for context. The company needs a CEO, but also needs to establish



bench strength in underlying executive positions. As such, we are seeing boards become much more interested in learning about the talent that is one, two, and often three levels below the CEO.

**Griffin:** Developing viable candidates may require moving executives aside who are “blocking” the natural process of succession. One of our Fortune 50 clients two years out from a scheduled succession event transitioned three individuals out of the top management team in order to make room for the succession candidates. The board and CEO made the succession plan operational by having the courage to proactively make moves on the top management team. This exposed the candidates to new roles and gave them a place at the executive team level. This transformational experience resulted in three viable internal candidates at selection time. Succession planning needs to be done in a proactive and deliberate manner in order to avoid unplanned firefights and the associated disastrous outcomes.

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**CSI:** Another part of your practice includes board effectiveness and board advisory services: What are some of the trends in board education that you expect to see in 2014?

**Miles:** Directors are eager for a deeper dive into their companies’ business environment, operating environment, and

competitive environment. This deeper understanding allows them to engage in a more meaningful and productive dialog with the CEO and upper management so that they can get beyond the surface quickly. Best-in-class boards take this educational component very seriously. The business landscape is changing so fast that boards need this at a minimum to stay relevant and attuned to the opportunities and threats facing the business.

**Griffin:** Succession planning is another key area of board education. Many directors have not been through a succession event before, or have experienced it just one or two times. They need a robust process around learning about succession from advisors who have worked through a number of leadership transitions and seen what can happen.


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**CSI:** Can you define the concept of board succession and take us through a successful board succession process?

**Miles:** First, let’s talk about what it isn’t. Effective board succession isn’t about swapping out an outgoing director to fill the departing director’s shoes. There are so many factors that come into play—from shifts in regulations to new competitive threats to global market opportunities—that best-in-class boards know that they must take into account how a company’s needs may have changed when it looks at new directors.

What best-practice board succession is today is assembling a group of directors that meets the future needs of the company. This involves a substantive process that really digs into the heart of the matter—the company’s future success—and requires steps to ensure that a candidate is chosen who can lend wisdom and judgment, but also, just as important, work well with other board members. It’s important to take a deep dive to determine which capabilities are needed in directors to best meet the future needs of the company, and this is typically done through the development of a skills and experience matrix. It’s then important for the board to develop a robust interviewing and eventually onboarding process for new directors.

**Griffin:** For succession planning around board leadership – whether it’s for the chairman, lead director, or a committee chair role, the situation can be much more highly charged. When boards are choosing a leader from among their peers, the process is very delicate, as they are evaluating and rating each other rather than an external candidate. Who is “first” among a group of “equal” peers?

This is where it is vital that there is a rigorous and planned approach to board leadership selection, having a process in place takes emotion out of the decision-making. Having a process ensures that candidates for leadership posts are evaluated objectively rather than anecdotally by their peers. 

# INTERVIEW WITH CHARLES ELSON



Charles Elson is the Edgar S. Woolard, Jr., Chair in Corporate Governance and the Director of the John L. Weinberg Center for Corporate Governance at the University of Delaware. He is also “Of Counsel” to the law firm of Holland & Knight. His fields of expertise include corporations, securities regulation, and corporate governance. He is a graduate of Harvard College and the University of Virginia Law School. Professor Elson has written extensively on the subject of boards of directors. He is a frequent contributor on corporate governance issues to various scholarly and popular publications. He is Vice Chairman of the ABA Business Law Section’s Committee on Corporate Governance. He is presently a member of the Board of Directors of HealthSouth Corporation, a healthcare services provider. He is presently a trustee at the Hagley Museum and Library, the Delaware Art Museum, and the Museum of American Finance.

**“ACADEMICS ARE HERE TO MAKE PEOPLE THINK. THAT’S WHY WE HAVE TENURE, WHICH GIVES US THE ABILITY TO MAKE CONTROVERSIAL STATEMENTS.”**

**C-Suite Insight:** You've been with the Weinberg Center since 2000. Tell us about the work that the center does and the impact you've seen over the last 13 years.

**Elson:** Well, the whole idea was to become a bridge between the world of Delaware law, which is the primary regulator of internal corporate affairs around the United States, perhaps even globally, and the community that it regulates. We wanted to provide a place where the judges of the Delaware system could get together and meet and discuss and debate topics of governance interest with those whose opinions affect. The idea was to bring directors, academics, executives, investors, and the judges together in a single forum to talk about issues of corporate reform, with the idea that if all parties are in the same room and discussing these issues, then ultimately the reform that results is much more effective. That's really what we've done on topics ranging from audit committee reform to compensation to shareholder voting reform. Over the last 13 or so years, we've had many panels and conferences and research that looks at these topics with the idea of creating reasoned governance reform and explaining that reform both to the outside world and to the Delaware judiciary.

**CSI:** What accomplishments are you most proud of since you've been there?

**Elson:** I think a couple of things. I would have to say the peer group work that has come out of the Center involving compensation reform. I would also say the notion of proxy reimbursement, which was an important change to the way shareholder voting is conducted in this country. A change in Delaware law and a change in approach took place because of discussions here. I would say general acceptance of the importance of the institutional investor by the Delaware establishment and the importance of Delaware and the reasonableness of Delaware in regulating corporate conduct by the investor community.

I'd say those four things, I'm quite proud of. I would definitely say that proxy reimbursement and peer group reform is something that came directly out of it. Additionally, the whole notion of the independent compensation consultant came out of a lot of work we've done here. We've done a lot. It's hard to put my finger on one thing.

**CSI:** What role do you see academics playing in the boardroom?

**Elson:** Academics are here to make people think. That's why we have tenure, which gives us the ability to make controversial statements. We make controversial statements because it's important to get people to think and a good director, frankly, is always seeking

information and good thoughts from many different quarters. The idea is that, as an academic, if you push the envelope a little bit in terms of progressive reform and you get people to think about it, I think you've done your job. On the part of a director, a good director is seeking information from all different quarters and the idea of an academic is sometimes you'll get information from an academic or an idea that you wouldn't ordinarily come up with on your own, simply because you get comfortable with what you do. An academic is supposed to force you to think outside the box.

To me, the role of an academic is to create the kind of ideas and theories that make boards much more effective and I think on the part of boards, their role is to sometimes be receptive. On our part, we try to come up with different theories and by bringing people here and discussing those theories, hope the theories make their way into the water supply, if you will, and become reality. I think a lot of them have and simply that's the traditional role of the academic.

**CSI:** How do you see the role of academics evolving? Do you think the work that you are doing is going to become increasingly important?

**Elson:** I think the role of the academic will only continue to increase as the role of the



board becomes more important. I think boards, as they become much more monitoring in nature and have taken on such an important role and become such a focus of investors, how boards function becomes increasingly important. That's what academics write about and I think that because of that need for board change and the provision of product by academics and the easier availability of product through the Internet and things like that, I think you'll see the role of the academic continue to be important in the boardroom.

**CSI:** You talked about Health-South, a board you're currently serving on. How has your board service experience impacted your work as an academic?

**Elson:** It's a great chance to see the interplay between theory and reality. Sometimes theory and reality are two different things and serving on a board helps you understand where theory and reality meet and where they don't meet. You

can speak with greater credibility because you've actually been in a boardroom and if you haven't been on a board, people don't take you as seriously as an academic. Now that being said, as an academic, understanding how boards operate helps develop much more salable and sound theory.

One thing I've learned is boards are not monolithic. I think that that's been, for an academic at least, quite valuable experience. In many professions in this country, one learns to become sort of a sole operator. Boardrooms don't operate that way. Boards only work as groups with consensus. To build consensus, you have to deal with things in a different way than you might, let's say, as someone in a classroom. For me, that's been a tremendous experience, not only learning about how boards operate, but helping in designing theory that will be effectively implemented by boards.

**CSI:** How has shareholder engagement shifted in the past couple years since you've been serving on boards?

**Elson:** The idea of shareholder engagement was nonexistent 20 years ago. First of all, CEOs rarely talked to shareholders.

That changed 10 years or so ago. Today, boards now feel there's an obligation to talk to their investors. First of all, the investor community is not monolithic. There are differing investors with different goals and differing approaches and you can't view shareholders as monolithic, nor should you view directors as such. Boards are made of individuals. Shareholders are individuals each with different approaches and views. I think an effective director, a good director, is a good monitor and a good monitor takes in information from many different sources. Frankly, listening to your investors and understanding their concerns and desires and approaches makes you a much more effective director. I think that the key is the director is the representative of the investor.

**CSI:** What's your view on peer groups?

**Elson:** The peer group itself, once it became established, was based around the notion of easy transferability of executive talent. In other words, peer groups became accepted as the way to create pay because the view was that CEOs were talented individuals who could easily move to lateral organizations, similar organizations, and you needed to pay them competitively to attract and retain their talent.

The difficulty of the peer group is the peer group itself

“SERVING ON A BOARD  
HELPS YOU UNDERSTAND  
WHERE **THEORY AND**  
**REALITY** MEET AND  
WHERE THEY DON'T MEET.”

or the use of the peer group to create pay basically externalizes pay. In other words, a CEO's pay is created not by reference to what others within the CEO's organization are earning, but in reference to what others in different organizations are earning, different peer organizations.

The problem with the peer group is the peer group can be gamed. You will always naturally choose a larger higher-paying organization including your peer group, so that your pay will go up to reflect theirs, so that the peer itself can be gamed. The peer process itself targets pay to the 50th percentile or higher. No board aims below the median. This naturally will cause pay to increase each year almost geometrically if you're always targeting the median or above.

We did a study at the Center, which resulted in a paper called Executive Superstars, Peer Groups and Overcompensation that was published last year in the *Journal of Corporation Law*. What our study discovered is the fundamental theory or theme behind the peer group process, which is this notion of interchangeable talent, was empirically incorrect, that talent didn't move, that talent was much more organizationally specific than not and that the incidence of individuals moving to a lateral operation were very small and, in fact, when they did, they usually didn't do very well.

So the theory behind the use of the peer group, which is this notion of interchangeable talent, was flawed.

Our concern is that the more CEO pay becomes decoupled from the pay of everyone else in the organization, which is designed internally, you create disincentives within the organization to effectively produce goods and services for the company. The more CEO pay grows and becomes unrelated to everyone else, the less loyalty and discipline the other employees will feel to the organization. So what we propose is a replacement and what we're working on now is an alternative, an internally-based model where pay is designed in relationship to the pay of others within the organization.

We believe that this new SEC requirement of disclosing the ratio between the CEO's pay and the median pay in the organization will go a long way toward pushing along this notion that we're developing of internally-based pay. It will force boards to focus holistically on the entire organization.

**CSI:** So to clarify, it's not that you're against being aware of other executives' compensation, but boards need to make sure that the focus is much more on internal factors?

**Elson:** Right. The peer group itself could be useful as a reality check at the end of the process but using it at the starting point of the process, we think, results in skewed pay and pay that's organizationally separated.

## “THE PROBLEM WITH THE PEER GROUP IS THE PEER GROUP CAN BE GAMED.”

**CSI:** The theme of this issue of our magazine is Governance Outlook. What are the major topics of discussion in 2014 for corporate boards?

**Elson:** I think there are going to be a couple of issues. Certainly board de-staggering continues as an issue. I think the Chair/CEO split is going to continue to be an important issue. I think compensation will be the biggest issue and I think it's going to be because of this pay ratio that people will be talking about it. Not Say on Pay, because I do think Say on Pay has certainly focused boards' attentions on investors, because they hadn't really focused on them before, but I do believe the pay ratio is going to cause a real re-thinking of the peer groups on the part of the boards.

“[CORPORATIONS ARE] GOING TO DISCLOSE A VERY BIG NUMBER AND IT’S GOING TO MAKE THEM SICK. THEY’RE GOING TO HAVE TO COME UP WITH A WAY TO EXPLAIN IT.”

**CSI:** How do you see that playing out as far as impacting companies? Are they going to try and shoot for a certain ratio?

**Elson:** They’re going to disclose a very big number and it’s going to make them sick. They’re going to have to come up with a way to explain it. That’s what’s going to happen. It’s going to be an ugly number for a lot of companies and they’re going to be forced to explain it and when they explain it, if they have to explain it in terms of the peer group, it’s going to be very problematic. If they can explain it in terms of an internal company process, it’s a much more

palatable explanation for them, for their employees, and for the shareholders.

**CSI:** You mentioned board declassification as a big issue as well. How do you see that playing such an important role?

**Elson:** It’s really an accountability issue and also, if you combine it with the poison pill, it creates entrenchment. It’s accountability and entrenchment. It’s just one of these fundamental things for investors. They invest in you and they ought to be able to give you a thumbs up or thumbs down each year and I think the investors believe that it creates greater accountability and I believe in that, too.

**CSI:** How do you see the greater sophistication of shareholders having an impact on companies?

**Elson:** The more sophisticated the investor, number one, I think the more accountable the board and management will be to shareholders. More sophisticated investors ask better questions and hold you accountable, much more accountable, than those who are less sophisticated. Secondly, I think from the board’s perspective, having the views of a sophisticated investor is very important to your monitoring function. Again, a good board is always receptive

to all kinds of information and the better information you get from a sophisticated investor or sophisticated viewpoint the better job you can do as a monitor. So I think that the impact is that we have greater accountability and much wiser strategy going forward and better directors. It’s always good when you have a highly intelligent electorate. It’s helpful to you and helpful to them.

**CSI:** Do you think that board members today have enough stake in the companies of the boards they serve?

**Elson:** I think their shareholdings have increased dramatically and I think they’re a lot better than they were, I really do. I think the notion of most directors being paid at least half of their compensation in stock and the ownership requirements of many companies have increased stockholdings dramatically over the last 10 to 15 years. I’ve always said that I think you’ve got to have enough stock in a company that if you lose it, you’ll feel a real financial impact. I don’t think we’re there yet in terms of the strength of equity holdings, but I think we’ve come an awful long way. Put it this way, the more stock you hold, the more you’re aligned with investors as opposed to management. I think that’s important. **C**

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## 2014 COMPENSATION & GOVERNANCE OUTLOOK REPORT

For the full report, please contact Aaron Boyd at [aboyd@equilar.com](mailto:aboyd@equilar.com). Aaron Boyd is the Director of Governance Research at Equilar. The contributing authors of this report are Alice Avery, Silas Kwong, and Greg Leyrer, Research Analysts, and Hardeep Dhillon and Timothy Wan, Senior Research Analysts.

There were a number of important happenings in 2013, including a near default by the federal government, the confirmation of a new SEC chair, passage of the CEO pay ratio rule, and a strong stock market that led to resurgence in M&A activity. Developments like these will shape the business landscape well into 2014. Continuing discussions between companies and shareholders will drive changes as firms ensure their compensation efforts are communicated through a variety of mediums and methods. Concerns surrounding fairness in a number of areas including stock structure and pay will cause struggles between conflicting parties, as focus intensifies on board decisions. Topics featured prominently in this year's report include alternative pay, board diversity, Say on Pay responses, and pay for performance disclosures.

### DISCLOSING PAY FOR PERFORMANCE AND THE ISSUE OF REALIZABLE PAY

In an effort to make the CD&A more significant and reader-friendly, many companies have started incorporating additional graphs, charts, and tables illustrating how they apply pay for performance concepts. These illustrations convey important takeaways that further the conversation about specific trends. The variety of visual aids companies are using in proxy statements highlight issues relating to financial performance, compensation elements, pay mix, benchmarking practices, and CEO pay. Companies are dedicating a larger portion of the CD&A to explaining how an executive's pay aligns with the company's overall performance. These disclosures are not limited to pay for performance issues, but also relate to how that link has performed historically, and how it has made a material impact on CEO realized or realizable compensation.

## INCREASING OUTREACH AND SHAREHOLDER ENGAGEMENT

While three years of Say on Pay have triggered numerous changes to the executive compensation landscape, one of the least evident changes might be one of the most noteworthy. While not easily discerned in annual filings, the manner in which companies interact with shareholders regarding compensation and governance issues has evolved substantially.

In addition to an overall increase in shareholder outreach, a growing number of companies are voluntarily documenting shareholder engagement within their proxy filings. Shareholder engagement can take a number of forms, including distributing written materials, hosting virtual meetings or webcasts, and even convening in-person meetings. While many shareholders view this outreach as a necessity for companies that have failed Say on Pay in the prior year, shareholder engagement has become increasingly common, including at companies with Say on Pay votes that received near unanimous support. In addition to generating goodwill, proactive engagement with shareholders allows boards to assess any potential disconnects between parties prior to the annual meeting.

## FUTURE DISCLOSURE IMPLICATIONS FROM THE CEO PAY RATIO

On September 18, 2013, the SEC issued a new rule based on section §953 of the Dodd-Frank Act. The rule requires public companies to disclose the ratio between the median compensation of their employees and that of their CEO. SEC Chair Mary Jo White commented that there would be “significant flexibility in complying with this new disclosure requirement,” and her statement was largely borne out of the content of the proposed rule. The rule in its current form specifies that:

- Companies may use statistical sampling to calculate median worker pay.
- Foreign employees and part-time workers must be included.
- Only workers employed on the last day of a company’s fiscal year will be included in the calculation. No exception is made for seasonal workers.

## KEY FINDINGS

- Female directors join boards at higher rate. In 2012, 22.0% of new directors were female compared to 18.2% in 2011. At year’s end, 79.2% of S&P 1500 boards had at least one female member, an increase from 71.8% and 74.4% in 2010 and 2011, respectively.
- Retainers for directors continue to show large increases in value. The median value of board retainers in the S&P 1500 increased 29.4% over the last five years, from \$130,000 in 2008 to \$168,270 in 2012.
- Companies failing Say on Pay address concerns. More than 50% of the companies that disclosed changes following a Say on Pay failure in 2012 made changes to performance metrics.
- Nearly half of companies use TSR in long-term incentive plans. Total Shareholder Return (including both Relative and Absolute TSR) continues to be the most popular long-term performance metric, appearing in 48.4% of companies’ plans.
- Prevalence of performance shares continues to increase. The percentage of S&P 1500 CEOs receiving performance shares rose 10.0% in 2012 to 60.7%.
- Visual aids illustrating pay for performance alignment increase. The addition of graphs and charts to display CEO pay compared to company performance is becoming more common within the Compensation Discussion & Analysis.
- Shareholder outreach disclosure grows among companies. Many companies have been increasingly proactive about engaging shareholders, and across the board more companies are including details of outreach efforts including written materials, virtual meetings or webcasts, and in-person meetings.
- Innovations in CD&A design include simplifying compensation practices into summary lists. “What We Do vs. What We Don’t Do” sections are being used more frequently as a straightforward way to demonstrate best compensation practices.
- Companies weigh effects of CEO pay ratio rule on disclosure. An SEC ruling made on September 18, 2013 requires companies to disclose the ratio between CEO compensation and the median of annual total compensation of all other employees.
- More boards are chaired by their CEOs. Within the S&P 1500, 46.9% of companies have a combined CEO-Chairman position while 39.7% have a Non-Executive Chairman and 13.4% have an Executive Chairman.

- Companies will not be allowed to adjust compensation numbers to account for employees living in low-cost jurisdictions.
- Companies may annualize total compensation for permanent employees who were hired during the year if they wish.
- Companies must disclose the methodology used to calculate the ratio in the form of a “brief overview.” Companies need not provide all technical details, but must disclose enough so that readers can “evaluate the appropriateness of the estimates.”
- Disclosure of the ratio will be required beginning in a company’s first fiscal year on or after the effective date of the SEC’s final rule.

### SEPARATING THE CEO AND CHAIRMAN ROLES

A joint CEO-Chairman offers a strong unified leader that connects both the executive team and the board of directors. However, shareholders sometimes argue that a combined role may be detrimental to the corporation. The board’s role is to keep the CEO and executive team in line, but responsibilities blur when the head of the executive team and the board is the same person. Within the S&P 1500, there has been a 15.1% decrease in the prevalence of CEO-Chairman since 2008. Conversely, over the last five years, the percentage of independent Chairmen within the S&P 1500 has increased by 26.7%.

### INNOVATIONS IN CD&A DESIGN: OUTLINING PAY PRACTICES

Due to the increased focus on the disclosure of the CD&A, it is no surprise that the CD&A section has changed dramatically over time. Whereas the CD&A once read like a legal document, many are now written in a manner that is user-friendly for investors. Many companies now also include a clear and easy-to-read comparison table or

summary list comparing compensation practices that they use against ones they do not. In an effort to assure shareholders and investors that the company only utilizes what are deemed to be the best pay practices, certain proxy statements also contain information on practices seen as problematic by proxy advisors.

### FAILED SAY ON PAY VOTES PROMPT CHANGE FROM COMPANIES

Shareholders from 97.7% of companies approved their compensation programs, and positive votes were marginally higher than in the two previous years. Further demonstrating strong shareholder support, 77.5% of companies received greater than 90% support, an increase above 2012 and 2011 levels.

Despite the overall success for most companies, 2.3% of companies failed their 2013 Say on Pay votes, slightly less than the 2.5% failure rate of 2012. The relatively low failure rate over the first three years has increased the scrutiny faced by each of the companies that failed. As a result, look for companies to continue to take the Say on Pay vote seriously in 2014.

Pay for performance misalignment and problematic pay practices were frequent themes that led to Say on Pay failures in 2012. Consequently, they were the major areas of adjustment for companies that revamped their compensation practices for 2013. In a sample of 51 companies that failed their 2012 Say on Pay votes and discussed the results in their most recent proxies, slightly more than half noted a change in their performance metrics. This is the most common adjustment for 2013. Eight companies also cited overlapping metrics between short- and long-term awards as a reason for introducing new

Chart 1

S&P 1500 Board Chairmen

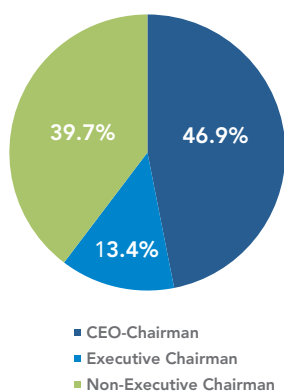
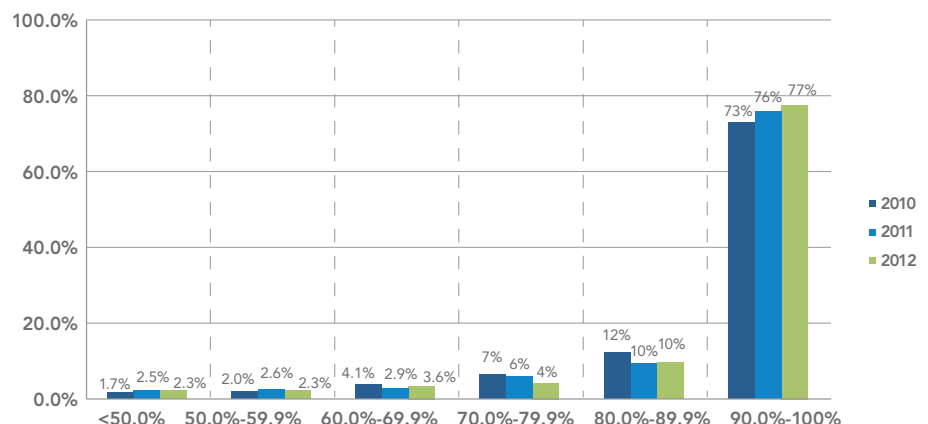


Chart 2

Say on Pay Results

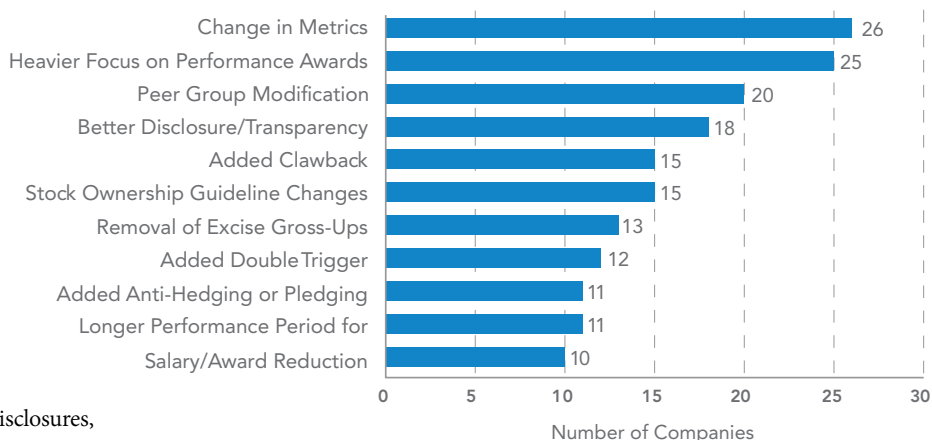


metrics, since that overlap is viewed as a poor practice by proxy advisory firms.

A general shift toward performance-based awards, peer group changes, and better disclosure of compensation practices were the next most commonly cited changes, with each of those changes discussed in more than 35% of proxies. Corporate governance, changes to stock ownership guidelines, additions of clawbacks, double-triggers, and anti-hedging and pledging policies each appeared in more than 20% of the analyzed companies' disclosures, showing a uniform push to implement what have become standard governance practices. Chart 3 displays the top compensation-related changes made by companies following a failed 2012 Say on Pay vote.

Chart 3

### Say on Pay Changes



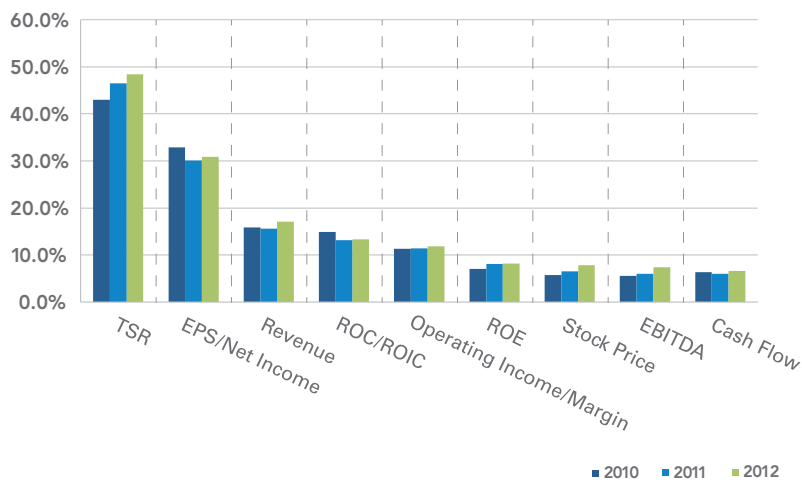
### LTI PLANS INCREASINGLY MEASURE PERFORMANCE THROUGH TSR

The percentage of S&P 1500 companies providing performance-based equity to their CEOs increased from 50.1% in 2010 to 61.8% in 2012. Equilar analyzed the most common metrics used in long-term equity performance plans. Total Shareholder Return (which includes both Relative and Absolute TSR) continues to be the most popular long-term performance metric, appearing in 48.4% of companies' plans. The second most popular metric is Earnings per Share, included in 30.9% of companies' plans. Earnings per Share is followed by Revenue, appearing in 17.1% of companies' plans. The most prevalent metrics are financial metrics, indicating that companies wish to use quantitative measures rather than qualitative metrics to measure long-term performance. Over the past three years, we see that companies consider TSR to be the best measurement of long-term performance.

Chart 4 compares the most prevalent metrics in long-term incentive plans for S&P 1500 CEOs over the last three fiscal years.

Chart 4

### S&P 1500 Long-Term Incentive Plan Metrics

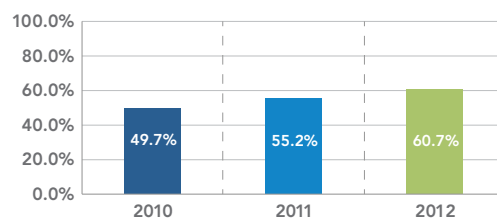


### PERFORMANCE SHARES BECOMING MOST PREVALENT EQUITY VEHICLE

The percentage of S&P 1500 CEOs receiving performance shares as part of their compensation rose to 60.7% in 2012. This is the third consecutive year of double-digit growth and an increase of 10.0% from 2011. Performance shares have

Chart 5

### S&P 1500 Performance Share Awards





become a solution for companies that want to align pay and performance to assure their shareholders and institutional investors that they have their best interests in mind. Equilar's 2013 Voting Analytics Report released earlier this year noted that increasing the percentage of "at risk" pay directly tied to performance was one of the most common changes made to compensation programs of companies that failed their Say on Pay votes the year before. Implementing performance shares, often in place of options or other time-vesting equity grants, has been one of the more common ways to achieve an increase in "at risk" pay.

### FEMALE BOARD REPRESENTATION ON THE RISE

Efforts to increase gender diversity on boards have increased considerably in recent years, and many boards are aware of the need and value of adding female directors. Women continued to join corporate boards at a higher rate in 2012 than in 2011. Of the 1,042 new directors elected in 2012 to S&P 1500 boards, 229 were female. This represents a 22.2% increase from the rate at which females joined boards in 2011. Charts 6 and 7 illustrate the gender breakdown of new directors joining S&P 1500 boards in 2011 and 2012.

In 2012, 15.0% of all S&P 1500 directors in 2012 were women, compared to 13.0% in 2010. Avon Products and Christopher & Banks have the highest percentages of females serving on boards, with an equal number of males and females on both of those boards. Estée Lauder's board continues to have the highest number of females serving on an S&P 1500 board with seven female directors, 47% of the company's total number of directors. Chart 8 illustrates the trend of increasing female membership on S&P 1500 boards. During 2012, 79.1% of S&P 1500 boards included at least one female, an increase from 71.8% and 74.4% in 2010 and 2011, respectively.

### UPWARD TREND IN DIRECTOR RETAINERS

Median director retainers have risen consistently over the past five years as part of a shift toward a more role-based compensation structure, and away from an attendance-based structure. The prevalence of meeting fees fell over the same period, from 58.8% five years ago to 38.7% today. Since 2008, median values of cash, stock, and unit components of retainers have all risen significantly. Only options have remained stable, slightly increasing from 2008 to 2012.

Commenting on recent board pay trends, Meridian Compensation Partners noted that cash retainers have maintained a growth rate of about 5.0% during the last five years, while base salary increases for executive officers have grown around 3.0% a year – an increase that makes sense considering the increased scope and exposure of directors' roles.

Chart 9 illustrates the breakdown of director retainers by component including cash, stock, options, and units. **C**

Chart 6

New Directors in 2011  
n=1,037

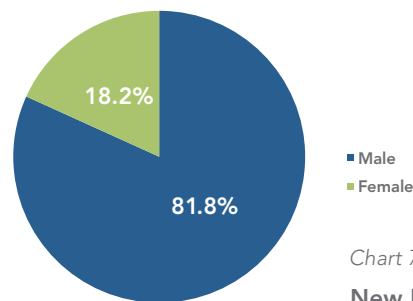


Chart 7

New Directors in 2012  
n=1,042

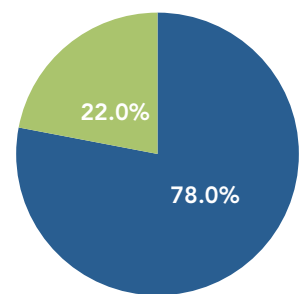


Chart 8 S&P 1500 Historical Prevalence of Female Directors

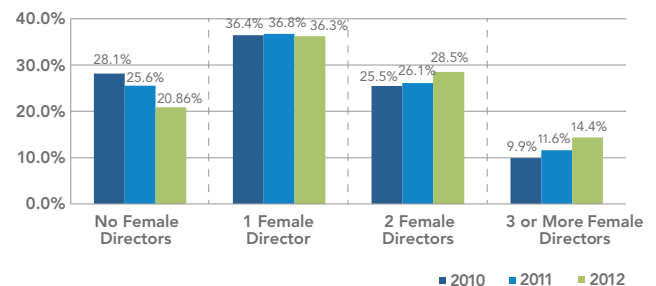
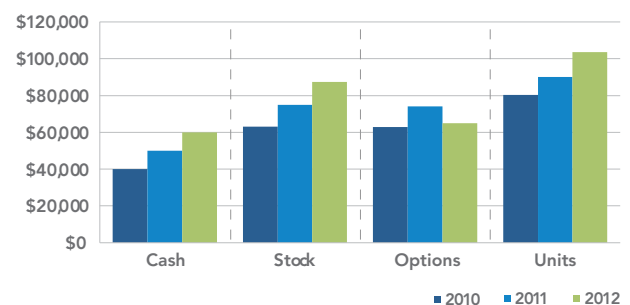


Chart 9

Median Director Retainer Component Breakdown



## S&P 1500 BOARD PROFILE: COMPOSITION & RECRUITING TRENDS REPORT

For the full report, contact Aaron Boyd, Director of Governance Research, at [aboyd@equilar.com](mailto:aboyd@equilar.com). The contributing author of this report is Belen E. Gomez, Senior Governance Editor, [bgomez@equilar.com](mailto:bgomez@equilar.com).

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As the regulatory environment evolves and companies' business strategies change, so does the expertise required to serve on a board of directors. Building and maintaining a highly effective board is critical to ensure that boards remain vigilant, are effective in guiding strategic discussions, and ultimately steer their companies toward success.

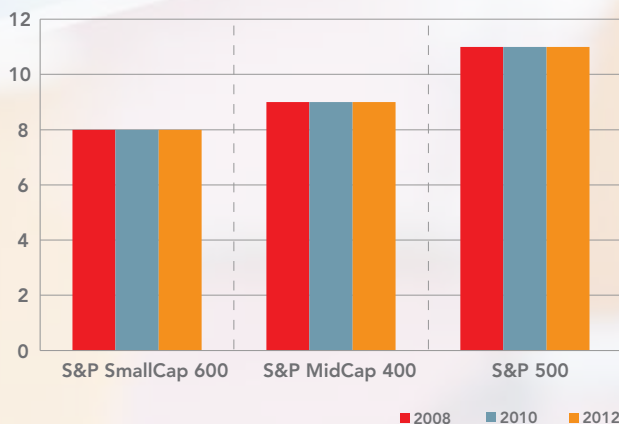
In an analysis of board composition over the past five years, the broader trends indicate that board size has remained consistent. However, much has changed in those five years regarding the composition of boards today. To provide a comprehensive profile of board composition, we researched companies within the S&P 1500 to produce this third report of a three-part series covering board retainers, committee fees, and board composition. We partnered with NYSE Governance Services, Corporate Board Member (CBM) and The Miles Group to compile this detailed overview of board composition and board recruiting trends. To complement the in-depth data review, CBM and The Miles Group provide additional analysis and perspective on this critical governance topic.

### BOARD SIZE

In an analysis of board size across the S&P 1500, the largest boards are found in the S&P 500 companies, which have a median board size of 11 members. Mid-cap companies have a median board size of nine members, and the smallest boards are found at small-cap companies with a median of eight board members. These numbers have been consistent across the indices since 2008.

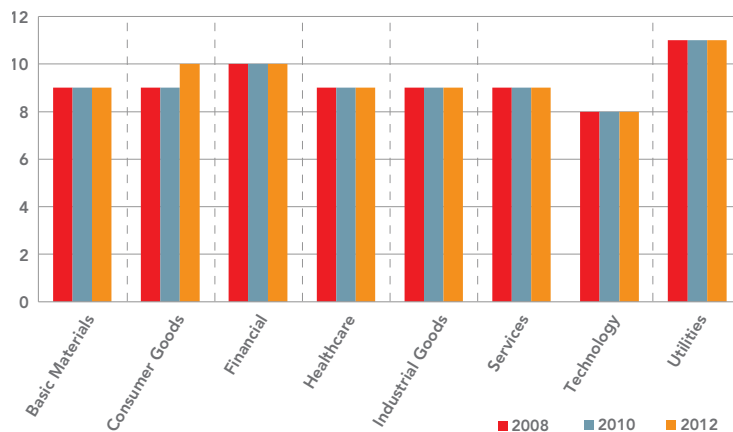
Similar analysis by sector in the S&P 1500 indicates little variance in board size over the past five years. Board size was largest in the Utilities, Financial and Consumer sectors which had medians of 11, 10 and 10, respectively. The Consumer Goods sector had the only increase in board

Chart 1 Board Size by Index



size, from a median of nine members from 2008 through 2010 to 10 in 2012. The Technology sector had the smallest median board size of eight board members. The other half of industry sectors had a standard median board size of nine members, which has remained unchanged since 2008.

Chart 2 Board Size by Sector



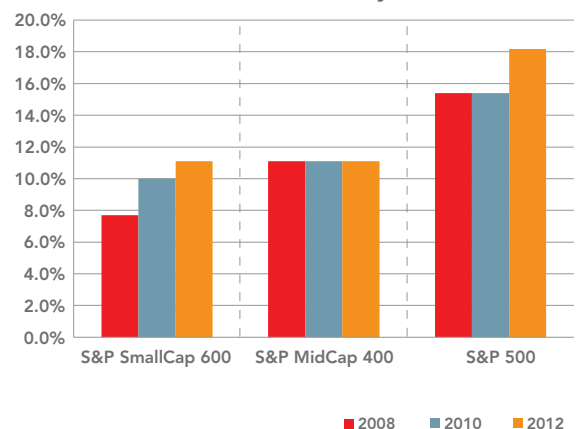
## KEY FINDINGS

- More women directors make up large-cap boards. The largest increase of female directors was in the large-cap, which increased from a median of 15.4% of female directors serving in 2010 to 18.2% in 2012.
- Technology companies have the youngest boards. The smallest reduction in median average age was in the Technology industry, decreasing from 63.4 in 2008 to 61.2 years of age in 2012. The tech sector had the lowest median age throughout the study periods.
- Lead directors are the least prevalent at small-cap companies. Though there was a 12 percentage point increase for small-cap companies, the small-cap still has the lowest prevalence of lead directors with 40.9%.
- CEO experience is still desirable for new board members. The prevalence of directors who have CEO experience is just more than 14.0% and is relatively consistent across the indices, compared to directors with CFO experience at just more than 3.0%.

## GENDER REPRESENTATION

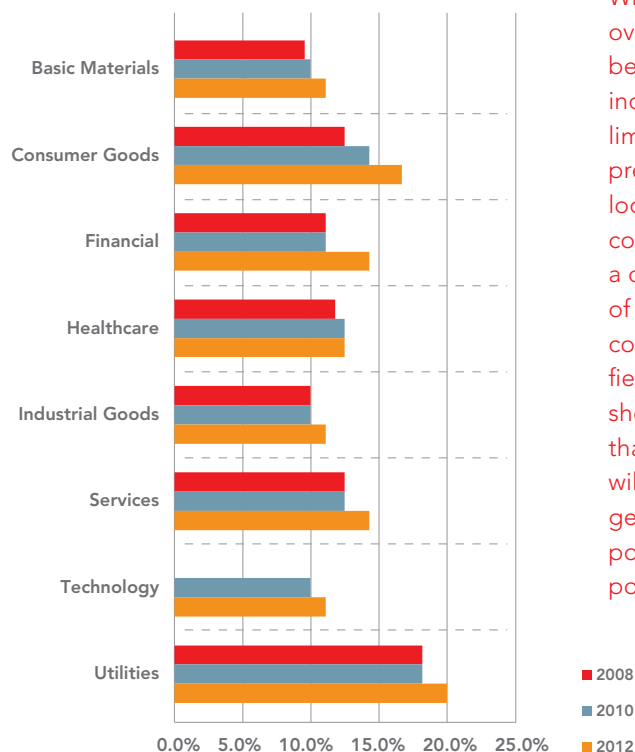
The percentage of women directors increased within small-cap and large-cap companies. The largest increase of female directors was in the large-cap, which increased from a median of 15.4% in 2010 to 18.2% in 2012. Within the mid-cap, prevalence of women directors has remained at 11.1% since 2008. For large-cap companies, the median number of women directors on boards was two, while the median in the small-cap and mid-cap has been one female director.

Chart 3 Percent of Females Serving on the Board by Index



The percentage of female directors has increased across industry sectors since 2008, with half the sectors showing increases only from 2010 to 2012. The largest increase was in the Technology sector, which jumped to 11.1% in 2010 from 0.0% in 2008. The next largest increase was in the Consumer Goods sector, increasing from 12.5% in 2008 to 16.7% in 2012. The smallest gains were made in the Healthcare and Industrial Goods industries, with increases of only 0.7% and 1.1%, respectively, however, in 2008 the Healthcare sector had a higher percentage than four of the other seven sectors.

Chart 4  
Percent of Females Serving  
on the Board by Sector



## NYSE GOVERNANCE SERVICES COMMENTARY

While there are some encouraging signs in specific industries, the overall increase of women and minorities on public boards has been slower than anticipated. There are several reasons for this, including a low rate of turnover on existing boards resulting in limited openings, the propensity of boards to want directors with previous experience, which eliminates new diverse candidates looking for their first board experience, the fact that smaller companies aren't subject to as much shareholder pressure to build a diverse board, and perhaps most importantly, the limited size of the pool of diverse senior officers and CEOs from prominent companies who are traditionally sought after as first-line, qualified candidates. The good news is that there is more light being shone on the value of diversity of thought and on having a board that properly reflects the markets it serves. In the future, this issue will be further propelled by existing international mandates to set gender quotas on boards and by certain geographic and political pockets in the U.S. that are setting guidelines for what board composition should resemble in the future.

## AGE

An analysis of age by index shows that large-cap and mid-cap companies have experienced the largest reductions in median average age since 2008. The median average age in the S&P 500 dropped from 65.3 in 2008 to 62.4 in 2012. In the mid-cap, the median average age dropped from 64.7 in 2008 to 62.2 in 2012.

An analysis by industry sector reveals a similar trend, a decrease of average median age across all sectors. The largest reductions were in Industrial Goods, where the median age decreased 3.4 years to 62.4 years of age, and Basic Materials, which decreased 2.9 years to 62.5 years of age. The smallest reduction in median average age was in Technology, decreasing from 63.4 in 2008 to 61.2 years of age in 2012. The tech sector had the lowest median age throughout the study periods. The industries with the highest average median age were Utilities (63.2) and Financial (63.0).

## NYSE GOVERNANCE SERVICES COMMENTARY

While board diversity numbers will continue to rise, it's safe to say that the average age for boards will continue to fall. We're seeing younger and younger people being invited to serve on boards due primarily to their early experience in running companies—particularly those in the tech or digital space. Adding to that is the fact that younger people better understand the new paradigm of cyber risk and opportunity, which is very important today. Interestingly, bringing younger people on boards has created a new dilemma of determining how long a director can responsibly serve on a board or how long he or she can remain independent. For this reason, it is reasonable to expect more focus on term limits, or at least formal independence guidelines, which exist successfully as part of board governance structures in many overseas countries.



## TENURE

Board member tenure has stayed relatively consistent over the past five years. Median average tenure of board members increased from 8.70 years to 8.72 in the large-cap, while in the mid-cap it increased from 8.96 to 9.29 years. In the mid-cap, median average tenure decreased from 9.60 years in 2008 to 9.53 years in 2012. Board members in the mid-cap have the shortest average median tenure with 8.72 years.

## THE MILES GROUP COMMENTARY

The issue of director longevity is one that can lead to tricky boardroom situations. While there are certainly some directors who are so valuable that people want them around for a long time, problems may arise when those who bring less to the table are reluctant to step down as their effectiveness and relevance wanes.

When directors are underperforming, this is a problem in its own right. But what magnifies the problem is when the board is not regularly evaluating the performance of its individual directors such that underperforming directors are allowed to stay well past the point at which they are actually being useful. Having these directors around at the very minimum draws down the effectiveness of the board—and, at its worst, these directors can become toxic on the board, causing outright dysfunction.

This is when it is critical for chairmen or lead directors to step in and get into serious diagnostic mode. The best boards are already adopting rigorous annual performance reviews, and moving past the compliance-driven, check-the-box evaluations. Most boards ask their CEOs to conduct annual assessments of their team, and it makes sense for the board to do the same for themselves, not just around governance issues but also around skills and experiences as well as contribution. The best directors want feedback and want to grow and increase their effectiveness.

## LEAD DIRECTOR PREVALENCE

Lead directors are most prevalent in the S&P 500, which is likely influenced by a higher percentage of large-cap companies with combined CEO/Chair roles. In 2012, 52.7% of companies had a lead director, up from 39.1% in 2008. There has also been a steady increase in prevalence in the mid-cap (44.8%) and small-cap (40.9%) of companies. Though there was a 12 percentage point increase for small-cap companies, the small-cap still has the lowest prevalence of lead directors.

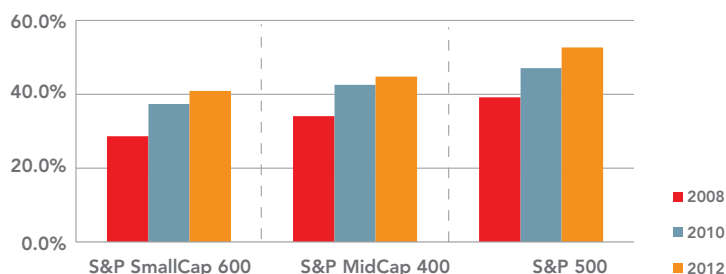
## THE MILES GROUP COMMENTARY

As the number of lead directors rises across almost all indices, this board position is gaining power as an influencer of board decision-making, especially during times of crisis. As lead directors play an important role in some of the most sensitive areas of governance, including CEO succession planning, boards are increasingly turning their attention to this role and how it can best be tailored to suit the particular needs of the company and governance challenges.

Depending on the strengths and character of the CEO/Chairman, as well as the pull of the rest of the board, a lead director has to negotiate a complicated set of dynamics. The best lead directors will have a strong, supportive relationship with the CEO/Chairman, but also not be afraid to challenge and question when needed. The lead director needs to be able to accurately represent the collective voice of the board to the CEO—and this includes delivering feedback on the performance of the CEO. That the lead director is responsible for the CEO's annual evaluation makes the role that much more "delicate" as well as critical to the organization.

At the same time, lead directors are expected to chair executive sessions, help the CEO plan the agenda for board meetings, and play an important role in ensuring that the board operates at the right level. In their more "board-facing" role, lead directors can coach their fellow directors on their interface with the company's management team so that the board is able to interact effectively—both hearing what management is saying and also communicating expectations.

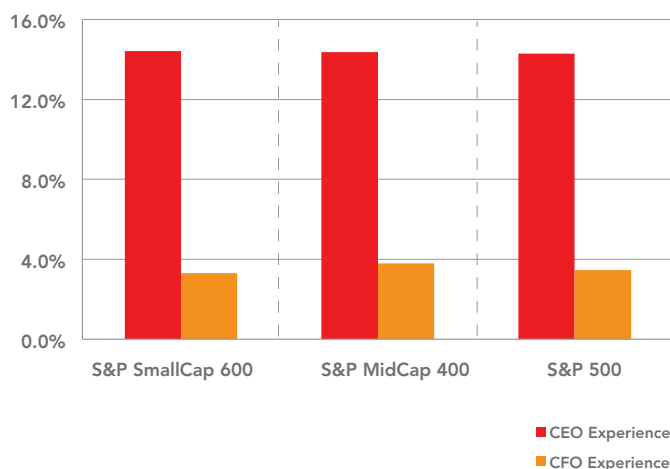
Chart 5 Lead Director Prevalence by Index



## DIRECTOR EXECUTIVE EXPERIENCE

In recruiting new board members in recent years, current or former CEOs and CFOs were at the top of boards' wish lists. An analysis of CEO and CFO experience within the S&P 1500 indicates the prevalence of directors who have CEO experience is just more than 14.0% and is relatively consistent across the indices. Similarly, the percentage of directors with CFO experience was consistent across indices at just more than 3.0%, with the highest prevalence in the mid-cap at 3.8%.

Chart 6 Directors' Executive Experience



## NYSE GOVERNANCE SERVICES COMMENTARY

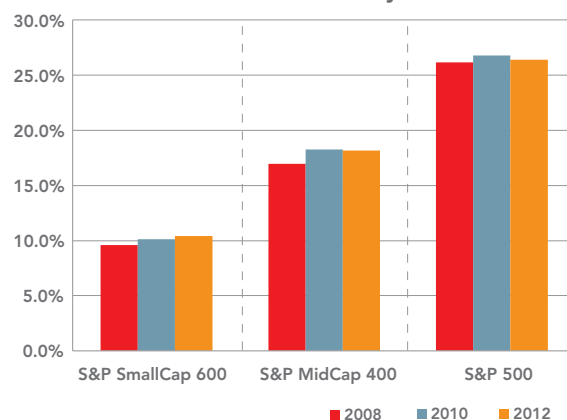
Whenever you ask a board what type of board member it is looking to recruit, it is common to hear that a sitting CEO or at least a recently retired CEO is most desired to get that top-level operating experience. If the board needs help with the audit committee and is seeking a financial expert, companies will often search the CFO ranks to find such a candidate. The fact of the matter is we are seeing fewer CEOs taking multiple board seats and subsequently, the demand far exceeds the supply. This is primarily because CEOs are concerned about how much time is required to serve on today's boards. Also, in many cases, companies have restricted their CEOs to only serve on one outside board, thus keeping their attention on their own company.

This paradigm forces nominating committees to be more creative in recruiting board members, which, in my opinion, is not necessarily a bad thing. Boards should undergo a skill-set matrix analysis to better understand their strengths and weaknesses. Often a blend of CEOs together with a blend of other senior officers, retired accountants, or general counsels can create a good skill balance on a company board.

## PREVALENCE OF MULTIPLE BOARD SEATS

Within the S&P 500, the percentage of directors with multiple board seats has remained at just more than 26.0% over the last five years, highest among the indices. Small-cap companies had the lowest percentage of directors with multiple board seats, increasing from 9.6% in 2008 to 10.4% in 2012.

Chart 7 Prevalence of Multiple Board Seats by Index



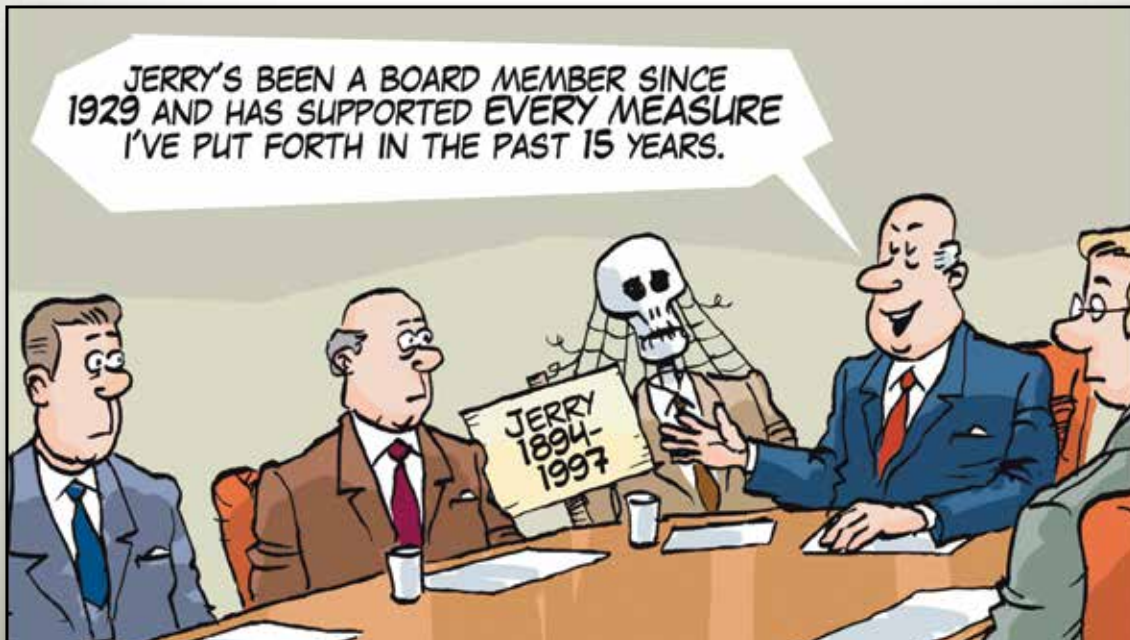
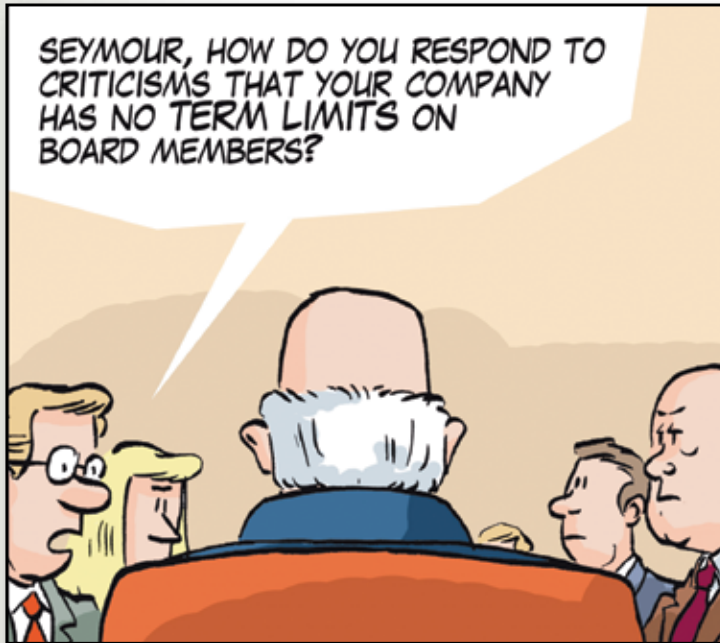
## THE MILES GROUP COMMENTARY

While companies don't want to have directors who are "over-boarded," there is much value in directors' bringing in expertise and insights from complementary industries. Ideally, you want people in the board seat who have experienced some of the same challenges the company might face. Projecting forward, what are the types of skills and experiences needed on the board to help the CEO navigate from a strategic perspective? Directors garner these skills from their previous experience as an executive, their current experience as a sitting executive, or from their other board memberships. Just like senior executives, boards want directors who have an outside-in perspective, and often times they receive this by serving on other boards.

What you need as much as expertise, however, is a commitment from a director to devote the hours and hours needed for best-practice governance. Board service today is more demanding than ever, and directors have to be able to stand up to the increased scrutiny of their decisions among all stakeholders.

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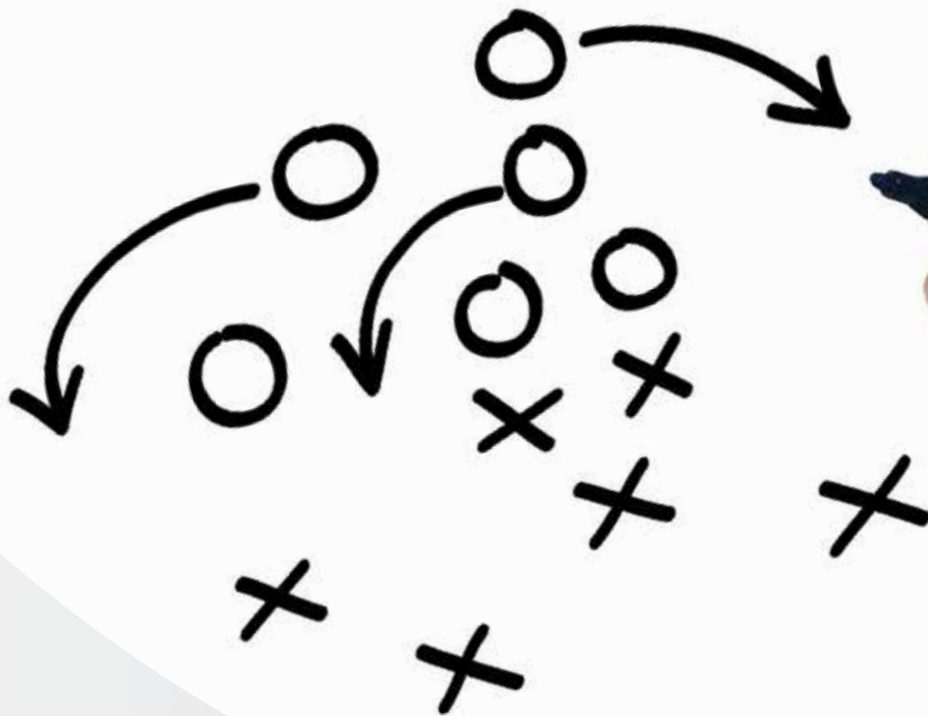
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