

Your Proxy As A Leading Indicator

Companies are presented with a myriad of board and governance issues. Many of these issues are intertwined so it's difficult to resolve one without addressing the others.

The SEC rules for expanded disclosure of compensation and corporate governance practices, offer a good starting point for moving forward. Publically traded companies implement these requirements in their annual proxy statements. The questions raised also apply to private companies.

Companies are required to discuss several important topics in their proxy statement: Board Composition, Board Diversity, Board Leadership and Risk Management. These topics are relevant for every CEO and board.

Board Composition

Companies must disclose the process for identifying and nominating directors as well as the value that each director adds to their board. This raises some very important questions.

- Do you have the right board members?
- How do you refresh your board and add necessary new skills?
- What skills do you need to address the issues your company is facing?
- How do you add or replace directors to help you achieve your goals?
- How do you assess your board's performance?

Board Diversity

Companies are required to disclose how they consider diversity when identifying and selecting directors. Questions to be addressed include:

- Why diversity is important to you and your board?
- How do you define diversity?
- How do you attract and retain diverse board members?
- How do you effectively manage diversity?
- What issues does a diverse board raise?
- What are the implications of diversity on board leadership?

Board Leadership

The board's leadership structure needs to be described. Rationale for the separation or combination of the roles of chairman and CEO needs to be provided.

- Do you have the right board leadership structure?
- Do you have the right board leadership?

Risk Oversight

Companies must publically address the issue of the potential for their compensation plans to create exceptionally high levels of risk. This requires a good review of all current incentive plans and the risks and behaviors that these plans encourage.

- Are your compensation plans driving the right behaviors?
- Do they provide the proper balance of risk and reward?

- Are there protection mechanisms to avoid or rapidly correct unnecessary risk taking?
- Do you and your board have a clearly defined process to identify and oversee risks?
- What is the risk culture you have established in your company and is the board comfortable and supportive of this culture?
- How is risk managed by you and your leadership team and overseen by your board or investors?
- How is risk linked to your business strategy, operational issues and competition?

Even if your company does not need to formally address these topics, they are still very important to leading your company and interacting with your board. These four topics frame out a good structure for evaluating current governance performance. We will discuss each in more detail in future weekly essays.