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ESG Oversight: How Directors Can Start the Conversation



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Transcript

Dan: I'm Dan Daly. Welcome back to Executive Insights. Today I'm talking with Melissa Means, a partner in the executive compensation firm Pearl Meyer, operating out of their Boston office. In our previous sessions we talked a little bit about the CEO Pay Ratio. We got into pay equality and the pay gap, and now Melissa has volunteered to talk about the “narrow” subject called ESG. Melissa, I'm going to toss the ball to you. ESG, what are you hearing about that subject, which is anything but narrow in the board room, from your time in the field and in the board room itself.

Melissa: Well, you're right, it is anything but narrow. So just to remind everybody, ESG stands for environmental, social, and governance. In any one of those three categories, as you can imagine, it's all encompassing. We're seeing so much more come up in companies around social quite frankly, right?

Dan: Right. Now, to interrupt for just a second, corporate responsibility is kind of part of that. I mean, corporate responsibility really includes ESG plus other things, but okay. All right, fine. They're synonymous and one and the same.

Melissa: Yes.

Dan: All right, I'm sorry to interrupt you, but continue.

Melissa: No, actually, that's a really good point of clarification because people use the terms interchangeably, which is good to clarify. What I was going to say was the reason why these things are coming up is we're getting a lot of pushback. Outside, right? So we've got activists. We've got institutional shareholders, and we even have proxy advisory firms like an ISS or a Glass Lewis, who are bringing up these issues.

Dan: And to a limited extent, government, regulatory bodies.

Melissa: Yes, absolutely. Absolutely.

Dan: I want to just say, the activists, a lot of times we think of the activists as the hedge fund or the private equity firm, who has a financial stake in the company. There's also the activist

who is focused just on social issues, and may have no more than two shares in the company, but comes to the meeting. I just want to make that point clear. A lot of people are focusing on ESG, not just one or two. Okay. I'm sorry. Continue.

Melissa: No, that's okay. The other thing I would say about ESG, and I think the reason why we're getting a lot of pushback externally on these particular topics, is because there isn't a lot of disclosure around this particular topic. For example, if I'm an institutional shareholder and I believe that a company may not be doing the right thing from an environmental perspective, I can't go pull an SEC document that's publicly available to find out exactly what a company's doing on these types of issues.

Dan: Good point. You can on compensation and you deal with that all the time.

Melissa: That's right.

Dan: Pearl Meyer and other firms don't necessarily deal with ESG and they're not necessarily in the proxy.

Melissa: That's exactly right. Or, you know, companies are left to decide, do I want to voluntarily disclose any internal information externally, on those topics. It's really kind of a fuzzy area—environmental, social, and governance—in that you can't really pick up a report and understand exactly what companies do.

Dan: Is this something that board members that you're talking with are worried about? The fact that this is not well defined, that people are kind of saying, "We want to know, we want to know," but there's no guidelines in terms of what should I tell them.

Melissa: Yes. So not only do you have it coming from external situations, or people and individuals and companies, but you also have it coming from the inside.

Dan: Employees.

Melissa: Employees, and #MeToo movements, or pay issues, pay gap, pay parity, those types of things. It's coming from a lot of different directions, and boards are now starting to say, "Gosh, you know, maybe we should be asking how is our company handling this internally if we're not familiar with this particular topic?" or "Are there areas from the governance perspective we need to spend some more time on to polish?" Or, as you know, culture, corporate culture, has come forward as a major topic, and the board has responsibility for oversight of that. How do you get your hands around it? As we said before, is really to ask questions around all these types of things. That goes into, part of it is social and governance as well.

Dan: I'm a board member and I'm an independent director. Who do I have this preliminary or this ongoing conversation with regarding what are we doing in my company of which I'm a board member. What do we do? Who do you have that conversation with? What's your advice to me? Who do I have that conversation with. Melissa?

Melissa: So I think it's fair, if you're sitting in a board room to ask the management team. You'd start with the CEO if you're in executive session, or whomever's participating at that particular time, maybe even including the legal counsel at that particular moment, is to just simply ask the question, "Hey, the next time we have a board meeting, could we do a short

session?" or however long you want it to be.

Dan: On what we're doing.

Melissa: Exactly.

Dan: Okay. On what our stand is, and what we're doing about these issues.

Melissa: That's exactly right.

Dan: I'm not looking for a 20-page policy report, but I'm looking, I'm looking for something. Okay.

Melissa: Well, in most boards, I've always jokingly said this, whether it's the compensation committee, subgroup of the full board or not, as a board member, you're really just looking to make sure that management has their arms around all of these things.

Dan: Yep. I agree. I agree.

Melissa: Right. And so by asking-

Dan: You're not going to run it, but it's an overview.

Melissa: That's exactly right. So by asking the question, help us understand what our company is doing around some of these things, as it relates to-

Dan: Or what we're not doing.

Melissa: Or what we're not doing, and-

Dan: Or what are our competitors doing?

Melissa: Or where there's opportunity.

Dan: Because on certain of these issues, a competitor might have a distinct competitive advantage, because the public says, "That's important, therefore I'm going to buy their whatever it is."

Melissa: That's exactly right.

Dan: Melissa, I'm going to jump ahead a bit. I don't know if you read it. I read very recently that a group of academics and some big institutional investors, CalPERS was one, Controller of New York was another, was submitting a petition to the SEC to ask them to put forth guidelines in terms of what was included in an ESG report, which is undefined at this point in time, and how it was made, and what it was made. I don't know if you've saw ... I just saw it once, but boy, CalPERS and New York Controller, those are pretty significant things. One of the schools was University of Pennsylvania.

But that went to the SEC and supposedly was signed by 70 or 80 people. I mean that's not insignificant when somebody ... That doesn't mean the SEC is going to drop everything and say it, but they were essentially saying, "Give us some guidelines on what should be included in the report." Okay. And how would it ... That's very significant. I mean, did you happen to see that, or that article? I think it was in the Wall Street Journal, or something, or have you heard anything like that?

Melissa: I hadn't actually, I hadn't actually seen the article, but it doesn't surprise me. Again, back to the point of, there aren't a lot of things that are required disclosures around all of those different topics. And so, you know -

Dan: But you live with CD&A, but we're all going to have to live with ESG in terms of reporting, maybe.

Melissa: Right, and so some companies voluntarily disclose around what they're doing in this topic, but it's not consistent, and it's not the same level of information. The external world is looking for more information to understand what are companies doing in the right way on all of these topics from an ESG perspective. So it's not surprising that there are petitions to try to move forward with more disclosure around them.

Dan: All right. I will follow that. I recommend our viewers, if they haven't seen that, maybe query the Wall Street Journal on that. Now that may be dead on arrival, but I just think when you've got CalPERS, they have done a lot of things in the governance area, in terms of demanding certain things from the companies they invest in. They could drive this alone. New York State Controller, equally, equally powerful.

Melissa: Well, it's quite possible. Both of them are very powerful and are activists in this area, to generate other institutions and investors behind them who are also looking for this information.

Dan: Absolutely. I guess that we're saying, we're saying it publicly, that a board and a company should not ignore ESG. By that we mean, what is your policy? Do you have one, and what are you doing about these issues? That doesn't mean you have to go from zero to 200 miles an hour, but you can't just be at the starting line saying, "We'll wait and see what everyone else does." You need some guidelines of what is involved in environmental, social ... I think there's a lot going on in governance, and people have a feel for what that is. That could be tenure on boards, qualification, or that type of thing. There's a lot of work to be done there, but they're not at step one.

Some companies on the other ... especially in the social, little bit on the environmental, because some of that is regulatory, but the social, no, that's different, that that goes back to the pay gap to equal pay, that type of thing we discussed in our first session. So I guess are you hearing a lot of discussion beyond, "Gee, it's out there. What are we going to do?" What are you hearing? You're the one that's in the boardroom.

Melissa: We are in the board rooms seeing it become a topic of conversation. Again, for a multitude of all those reasons-

Dan: Not necessarily on the agenda, but a topic of conversation.

Melissa: That's exactly right.

Dan: All right. Offline.

Melissa: That's exactly right, and there are questions around, what is our company doing? Give us some more education. Some companies are much more advanced on these particular topics, and the question has come up, of those that are not doing it, do we incentivize through our compensation program behaviors towards achievement of any of these

environmental, social, and governance issues?

Dan: Interesting point, Melissa. Is it a part of compensation, I presume at the executive level.

Melissa: Right.

Dan: Okay. Very interesting.

Melissa: Because again, incentive programs are meant to drive behaviors or-

Dan: Sure, sure. That's a very interesting one.

Melissa: So if the company-

Dan: Understandably from your background in compensation. Okay, yeah.

Melissa: So if a company needs to achieve on something where they haven't really spent a lot of time on that particular issue, should it be a part of the incentive program? We're starting to see that conversation come up. The other thing I'll mention is that, there was this whole step towards socially responsible investing, which we all read in the newspaper about that kind of a thing. As we think about companies that want to invest in our own corporations, they are now looking at different-

Dan: "What are you doing in the area of ESG?"

Melissa: "What are you doing? What are you doing on these issues?" If you think about it from that sense, it's important to get this level of information out. You just have to, one, as a board member, understand what is your company doing, and ask the question, broad open ended question, "Help us understand what we're doing. Give us a report back at the next meeting, so we know all the great things we're doing."

Dan: And there'll be a certain group of board members that say, "You know, all this takes place in a great economy when everyone's stock is up. I've been around a long time. When the stock goes down, all these issues will go away."

Melissa: Sure.

Dan: I don't think we can necessarily count on that. There's so much momentum that I think just to ignore it and say, "At the next down cycle, none of these issues. Pay won't be a problem. ESG Won't be a problem." I don't think that's realistic. I think it may not get the attention in a down economy, but I don't think they're going to go away. Do you agree with that?

Melissa: I completely agree. I think we're kind of in what I would call an evolutionary time-

Dan: I like it.

Melissa: As it relates to these exact topics. And they're really not going to go away. You're right, they might be dampened in the noise that they might create, especially in a down market. But for the moment they are louder, and the noise category from an external perspective. It behooves us to pay attention.

Dan: Right, right. Yeah. When you have unemployment at the 3 and 4%, okay, and the

economy is strong as this, these issues are not going to go away, and of course, so much money is controlled by a small number of institutional investors, and a lot of it public money, pension money. CalPERS we've mentioned earlier. I think, I guess you are saying to our viewers, that you really can't ignore this, because it is a paradigm shift. In a good economy it may get more attention, but in a down economy, some aspect of it is still there, and it probably should be there because it is the right thing to do. It isn't just because somebody is banging on your doors. A lot of these things that are included in it are the right things to do. Some of them are not, okay? They're nice to have, but there are ... I mean, let's go back to what really does it. Equal pay for equal work. Pretty basic. That is the thing that should be done.

Melissa: And legally required.

Dan: And legally required.

Melissa: Most places.

Dan: So part of the ESG are things that just make good business sense, but they also make good moral sense. Now, some of the other things that are a little more fringe, you may have to deal with, in order to stop the train and get off, but you can't ignore these things.

Melissa: I think you know when we talked about the evolution and just making sure you understand what your company is doing or not doing is also to be able to prioritize where you need to squeeze your time.

Dan: Yes. Great point. What's your company doing, what it's not doing, and what is the priority?

Melissa: That's right.

Dan: All right. Very important.

Melissa: Boards are so busy with so many different things now, if you don't prioritize, you're overwhelmed.

Dan: Right, right. And you take a situation and there are operational challenges. Let's look at General Electric. Okay. I mean, how much time could General Electric spend on ESG? They're trying to save the company. Okay. So that's interesting, and it gets back to board members have to know the breadth of their responsibility. We'll close with something. It gets back to what we talked about in all of our sessions, is asking the question and in this particular case, what are we doing in the area of ESG and how is my company defining ESG? Could you tell me? Don't be embarrassed by it, okay? Because you might be shocked or you might be pleasantly surprised.

Melissa: Dan, I would say when you, as a board member and asking the questions, never be afraid to ask it, because somebody sitting beside you probably has the exact same question, as you said earlier.

Dan: Great takeaway.

Melissa: But also I would say that by asking a question doesn't imply or suggest that there is a problem. Asking the question just simply says, "Hey, help me. Help educate us on exactly

what are we doing." Because quite frankly, there are a lot of companies doing some great things on all these different areas, but the board members may not know that.

Dan: May not know it, and the company may not be getting the bang for the buck of the investment they're making.

Melissa: That's right.

Dan: Great. Great. Let's close it there. Melissa Means has done a great job bringing information out of the board room where she spends a great deal of time. A lot of this information is well beyond just compensation. It's culture, it's company philosophy, and a fair amount of direction in what you should do as a board member. I think I'll summarize that with don't be afraid to ask the tough questions and don't be embarrassed. Melissa Means, thank you so much and I hope our viewers got a lot out of it today. I know I did, so thank you.

About the Author

Melissa Means is a managing director at Pearl Meyer with over 20 years of experience. Melissa's areas of expertise include executive and non-employee director compensation, designing, implementing, and communicating total compensation strategies, pay for performance alignment, and short- and long-term incentive compensation programs. She works closely with boards and management teams in addressing issues including governance practices, executive transitions, succession planning, and aligning pay with business strategies. Melissa specializes in working with firms ranging in size from small, private and pre-IPO organizations to large multi-national companies across many different industries including materials/industrials, consumer, healthcare, information technology, and biotechnology. In being in the boardroom most days with different clients, Melissa also helps provide context to boards on group behavioral interactions among the board and with management.

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Pearl Meyer is the leading advisor to boards and senior management helping organizations build, develop, and reward great leadership teams that drive long-term success. Our strategy-driven compensation and leadership consulting services act as powerful catalysts for value creation and competitive advantage by addressing the critical links between people and outcomes. Our clients stand at the forefront of their industries and range from emerging high-growth, not-for-profit, and private organizations to the Fortune 500.