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SPECIAL REPORT: CORPORATE GOVERNANCE

Back to basics

Stay focused on business, listen to shareholders

Commentary by **Thomas R. McGuigan and Melissa A. Plotsky**

Investors' anxiety over the global credit crisis and the collapse of confidence in financial markets means public companies should be prepared for more aggressive investor focus on financial performance, corporate governance and to a lesser extent corporate social responsibility.

"This is maybe a painful business cycle, but it's just a business cycle," he said. "Florida and Florida commerce is going to be there. We're really busy. We're hiring lawyers in Florida."

Corporate leaders who reach out to shareholders by anticipating needs and engaging shareholders are much more likely to come through the crisis with shareholder relationships intact.

To that end, leadership should first tackle executive compensation. A longtime focus of activist investors, executive pay is back in the spotlight in the Treasury Department's Troubled Asset Relief Program. Some say TARP could be the first step toward true regulation of executive compensation, but it is clear public companies should anticipate more proposals for so-called say-on-pay and claw-back proposals.

Say-on-pay proposals typically call for an annual advisory vote on executive compensation. Both presidential nominees supported say-on-pay legislation, which would give new weight to shareholders pushing for change.

Companies also should be prepared for claw-back proposals, which provide for recovery of executive compensation, particularly performance-based bonuses, in the event of financial restatements or inaccurate financial statements.

TARP's compensation restrictions require participating financial institutions to adopt a variety of compensation restrictions, such as prohibitions on incentive compensation that encourage unnecessary and excessive risks and golden parachutes.

As the credit crunch spreads, similar proposals might gain traction for nonfinancial companies. Businesses also might encounter shareholder proposals to replace "pay for failure" with "pay for performance" requirements such as eliminating tax gross-ups for senior executives, modifying or terminating severance pay for executives

ousted because of poor performance; requiring executives to hold stock following termination or until retirement; and ending so-called golden-coffin death payments other than compensation previously earned or vested.

Shareholders also will target the process of electing directors, among other corporate governance issues. Director election proposals will continue to emphasize majority voting for directors rather than accepting a plurality. In addition, shareholders can express their lack of confidence in management by withholding votes or by proposals reviving efforts to include director nominations in company proxy statements.

Changing director elections is just one possible item on shareholder agendas. Company leadership should anticipate proposals creating an independent, non-executive board chair and creating additional shareholder rights such as calling special meetings, terminating anti-takeover provisions and eliminating supermajority votes. Some shareholders might lobby to reincorporate in states such as North Dakota where recent legislation provides shareholder-friendly measures.

Given the wide range of proposals, public company leadership needs to go back to basics.

The first step is to stay focused on the business. Shareholders elect boards, and boards appoint management, which should spend its time managing the company while the board provides oversight and guidance.

The next step is for company leaders to start talking with and listening to shareholders, who usually aren't looking for a fight.

Our experience is that unless a shareholder has a fixed agenda, most shareholders are more interested in having a dialogue with management than battling over a proposal at an annual meeting. Management should be willing to discuss company practices and proposed changes to those practices. Management also should be willing in some cases to accommodate reasonable proposals in some fashion.

Whether through dialogue or revised company policies, even the most ardent activist shareholders are likely to perceive the board and management as responsive to shareholder concerns, and a proposal may be withdrawn before a shareholder vote.

Management also should remember that communication is a two-way street, and clear advance-notice bylaws can ensure shareholders' proposals are presented appropriately. Advance-notice provisions outline procedures that shareholders must follow to nominate directors or present other business at annual or special meetings. The notice informs the company and other shareholders about the proposal, including information about board nominees, and gives the board time to make an informed decision and recommend a position to shareholders.

There is a clear benefit for management that goes the extra mile by actively addressing shareholder concerns before they become a focus of shareholder attention.

Granted, there is no correlation between corporate governance rankings and company performance. But by anticipating shareholder concerns and addressing and resolving them directly, companies can put the matter behind them and focus on business.

To some extent, shareholder activism is making companies more responsive to meritorious proposals, shifting power from the board to shareholders and changing the role of independent directors.

Increasingly, directors are spending more time and energy on compliance with corporate governance requirements and proposals than they are providing guidance and strategy on the business of the company. An appropriate balance of the two is essential to a company's ability to face new challenges. ■

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