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GEORGETOWN LAW

DENNY CENTER CONVERSATIONS

A Q&A on Corporate Governance
with
Kimberly Simpson (NACD)
and
James Feinerman (Georgetown Law)

Kimberly Simpson
COO & General Counsel, National Association of Corporate Directors (NACD)

As Chief Operating Officer, General Counsel, and Corporate Secretary for the National Association of Corporate Directors (NACD), Kimberly Simpson is responsible for ensuring that NACD's operations meet its strategic objectives. She has specific oversight responsibility for the team that engages NACD's 23,000+ members, NACD Directorship Certification®, the NACD Chapter Network in 35 cities, marketing, and NACD Board Search. She also supports two boards of directors (NACD and the NACD Corporate Directors Institute). Kimberly frequently speaks and writes on governance matters.

Prior to joining NACD, Kimberly held a number of executive leadership roles. She served as executive vice president at Sanford Health, the largest rural, not-for-profit health care system in the nation with locations in 126 communities in nine states and in countries such as Ghana, Africa. She also was the inaugural president of the Edith Sanford Breast Cancer Foundation, an organization dedicated to raising funds to advance breast cancer research and treatment.

Kimberly received her Juris Doctor from the University of California, Berkeley, and is admitted to practice law in California, Virginia (as in-house counsel), and Texas (inactive). She has a Master of Arts in journalism from The University of Texas at Austin and a Bachelor of Arts in Spanish summa cum laude from The University of Alabama. Kimberly was a U.S. Marshall Memorial Fellow to Europe in 2005.

James Feinerman (Denny Center Faculty Chair) and Bruce Shaw (Denny Center Executive Director) had a chance to visit with Kimberly on campus in April 2023; Georgetown Law Professor Sam Flax also joined the discussion. The following has been edited for length and clarity.

Bruce Shaw: Thanks everyone for joining us. We really appreciate you being here. The mission of the Denny Center is to reconcile the benefits of free market capitalism with the needs, values, and expectations of a democratic society. How do we steward our economic system in a way that serves society, recognizes its many benefits, but also recognizes some of its sharper elbows and issues that need to be addressed as we think about the future? Today we're excited to welcome as our guest Kimberly Simpson, COO & General Counsel of the National Association of Corporate Directors. NACD has over 23,000 members representing over 1,750 boards, and it has been providing unique content and gathering opportunities to empower and educate corporate directors for over 45 years. Welcome Kimberly!

Kimberly Simpson: Thank you for having me. To follow up on our membership, we have 20 chapters that cover 35 cities in the US. All our chapters are led by people who sit on boards of directors themselves, and volunteer their time for us. About 60% of our members serve on the boards of public companies, and about 35 percent serve on private company boards. Our focus is to educate directors and empower boards, and to improve their performance, which in turn improves the performance of companies and through that, improve our economy and our communities. We provide directors with knowledge on the nuts and bolts of governance, and also help them see around corners regarding emerging issues. Perhaps most importantly, we bring members together to learn from each other because that's really where they find the most value is. In fact, I am flying to New York tonight where we are convening some of our Fortune 100 board committee chairs.

Bruce Shaw: That's terrific, thanks Kimberly. With that, I'll turn to our first question: How is the corporate boardroom different than before NACD got its start in the late 1970s?

Kimberly Simpson: First, we have to spell out the two main boardrooms we're talking about: public company boardrooms and private company boardrooms. Public company boards tend to be somewhat more homogeneous in how they operate, but private company boards come in many shapes and sizes including those for family-owned businesses, private equity-backed businesses, and startup businesses. Since there are all kinds of different private companies, the opportunities and challenges they face can be markedly different, so I'll focus my response mainly on public company boards.

Boards have experienced a number of external pressures, regulation, and events over the past 40-plus years, including evolving social norms and expectations around ESG, Sarbanes-Oxley in the aftermath of Enron, Dodd-Frank in the wake of the 2008 financial crisis, a rise in shareholder activism, the recent advent of employee activism, and new cyber security threats. As a result, directors have asked for education in new areas, and we see board forming new committees. Historically, you have typically had the audit committee, the nominating and governance committee, and the compensation committee. Banks might have a risk committee, but now you're seeing a proliferation of other committees, some ad hoc and some standing. Some of the committees, like audit, have seen their docket expand because of new regulations, but also because of new risks like supply chain risks.

We have also seen the rise of monolithic institutional investors like Vanguard – though they're not likely to move in and out of your stock, they carry a lot of weight. If you have an activist at the door, they're going to try to get those institutional investors on their side, and if they do, they're likely to win. Then there are the proxy advisory firms who are looking at a company's governance and filings in order to make recommendations on how shareholders should vote on different proxy proposals.

Bottom line is that it's a very complex environment. And even within the last couple of years, you were looking at spending about 245 hours a year as a corporate board member. Now I think you're probably likely well over 300, maybe even to 350 hours for some boards. And think about a pandemic on top of that.

Jim Feinerman: This brings up a couple of things that I've thought about. One is just trying to teach this material in law school classes. I remember putting together a slide deck, this was probably about 2002, 2003 after Sarbanes Oxley came into play. And then Dodd-Frank came along and it was just the one thing after another so that eventually there was an expanded file and you're trying to figure out what to keep, jettison and what to say, well, this is maybe pending, but you should be thinking about it as we go forward. And at the same time, just reflecting on the fact that the kind of companies that were evolving were very difficult to get your mind around.

In 2006, I was on a Fulbright in China, and I was briefly interviewed some time after that -- when Steve Schwartzman set up something called Schwartzman College in Tsinghua University in Beijing, where I taught while there -- on the one hand I said, I commend you for wanting to do this, but have you thought about all the risks that you might be taking in China? He said, oh, for sure, I have people who manage that for me. And then of course, the pandemic happened in China. So these are things that are somewhat on the horizon, maybe very distant blips on the horizon or not on the horizon at all. And you're trying to evaluate all of those things if you're intending to be a long-term investor or informed board member.

Serving on a corporate board is not what it was 50 years ago, when boards were more homogeneous and members often knew one another from graduate school or the local social club. Boards now need members ready to engage issues that have emerged from the twentyfirst century global business environment. The new realities have changed the overall content and membership of the board, but also they've significantly shifted the agendas of the committees.

Kimberly Simpson: You've raised some important issues, Jim, and I do think that we should talk further about how different the composition of the board looks in 2023. Years ago, a former CEO thought, "I'm retiring, and the next step is going on some boards." But that's not the mantra anymore. Board service is not a retirement activity. It's a lot of work and serious business. One example of this is the renaming and expanding charter of the compensation committee. It may now be called the human capital and compensation committee, in recognition of the importance of not just the compensation for executives, but the equity of pay, and the culture inside the organization and how it looks at the top and in the middle at the bottom.

Bruce Shaw: This is probably a good time to describe a typical public company board. The typical size of the board is around 10 or 12 people. And within probably the typical board, you can have from four to six or more committees. Does that sound right?

Kimberly Simpson: Yes. And like we've discussed, the typical committees include audit, compensation, and nominating and corporate governance. In addition, boards may have other committees focused on risk oversight or , technology, and digital transformation.

Jim Feinerman: And just to interject, the core committees – audit, compensation, and nominating – are made up of 100% independent directors.

Kimberly Simpson: There's also a recent trend to split the roles of CEO and Chair of the Board, with more and more boards taking this approach. For companies with CEO's that still also hold the chair position, the board will name a lead independent director who takes a leadership role among all the outside directors. I think the most recent data shows that almost 40% of public companies now have independent board chairs.

Audience Member: You mentioned that earlier that the world of corporate governance in the U.S. will look to Europe to see what might be coming next. Why do you think that is the case and has it changed?

Kimberly Simpson: First, companies in Europe typically operate in a more regulated environment that those in the U.S., and boards there have to be ready to advise management teams as they navigate those complexities. Second, there are different governance requirements. For example in Germany, you have to have a certain number of employees on the board, and the board chair must be an independent director. While there's no guarantee of these aspects catching on here, European business sometimes provides a preview of what might be in store for us.

Jim Feinerman: I'll add a couple of observations. First, I think there was a period, and it may have ended slightly before the Trump administration came into office, when it seemed there was a trend of an emerging economic might in Europe. European companies that were making global acquisitions, and it seemed like they were going to be a new group of global powerhouses. But then that shifted back, in part because of Brexit, and also the idea that things were not necessarily as rosy as they seemed. Until 2016, this had been a reaction again to what happened in the United States in 2008-2009, and it looked like Europe was coming out of that better than the United States, so maybe we should follow their lead.

The other thing, and I say this because of my other academic interest, China has been also an important factor in this. Though China is almost a negative example as far as governance is concerned – because they don't really have it as we define it -- they still have these enormous corporations. I think the four large Chinese oil companies are in the top 10 of corporations globally in terms of capitalization. While we can't learn much, if anything from China, regarding governance practices – and it doesn't say anything about the values that they espouse and the results that they cause – they demonstrate that you don't have to have the corporate governance we think is mandatory in order to have a large economic enterprise.

Kimberly Simpson: One last thought. We should not forget about the difference between the European mindset and the US mindset, which goes back to our expansion of the west. We have the feeling in the United States that we can do anything we put our minds to. We just need enough time, enough money. That's different in Europe. The way we grew up as a country fueled our spirit of innovation, but I don't know if that's changing. We'll see.

Audience Member: I'm a first year, so I haven't taken corporations or corporate governance. I am curious about how a board's performance is measured. I'm assuming if it's a public company, it might be attached to this company stock price, but for private companies and as well as the public company, or are there other metrics that are used to judge board performance?

Kimberly Simpson: That's a really good question. For public companies, it's clear, and you nailed it: it starts with the stock price. Board members are also evaluated in a sense each time shareholders vote to retain them – or not. Many boards also review their own performance annually, but some boards are more rigorous than others in this self-evaluation process. At the end of the day, however, the board is about creating shareholder value, and the best way to measure that is watching the stock price over time.

With private companies, it's a lot more opaque even though the concept is the same. For a family-owned business, the owners have a lot of control and can create their own litmus test, such as whether a board member is bringing contacts for funding or new banking relationships.

And from a nonprofit perspective, things have become more complex. For larger nonprofits, they may look at fundraising, operational efficiency, and compliance, such as steering clear of any self-dealing.

Jim Feinerman: I would just add two things. One, going to the nonprofits. Georgetown is a nonprofit, and one of the questions that's raised about universities in general is exactly how constrained they are by corporate governance principles because they can create the impression that there's a kind of struggle between educational values and corporate values. If you question what they're doing, they say, well, this is because of our educational mission, and this is what we have to do. In the late 1990s, Georgetown ran up a large operating deficit at the medical school, and various constituencies asked if the board had been asleep at the switch. Not long after, the then-president was fired, and the board hired our current president to remedy the situation.

Two, I think one of the advantages that for-profit corporations have is there's a bottom line and it's much easier to see quarter by quarter what's happening with stock prices and other things. Whereas in the nonprofit organizations, there's more of this kind of go along to get along. I would always say that in this, there's an advantage to being a corporate board where there's a kind of bottom-line measure.

Audience Member: For public company directors, what emerging issues do you see in overall risk management compliance, and also as it relates to reputational risk management?

Kimberly Simpson: When we go out and survey directors every year, both public and private, we usually hear similar themes. Right now, boards are concerned about economic uncertainty and inflation risks. Another area of risk-related concern is related to supply chain issues due to the lingering impacts of the pandemic-related disruptions and also climate-related disruptions. One of our directors was sitting on a board whose company produced vanilla, and after a series of weather-related events in Madagascar, the company realized that it’s supply chain was too dependent on one country and is looking to diversify its suppliers.

Another key risk boards mention is talent attraction and retention. We're moving into a world of data, we're moving into a world of AI, we're moving into a digital world, and we do not have nearly the talent or the people to fill these new tech-savvy jobs, nor do we have an abundance of CEOs who've gone through a big digital transformation for example.

Lastly, boards are quickly getting up to speed on cyber-security risks. These aren't new as a category, but the space is changing quickly, and new threats seem to emerge weekly, if not daily. The issues range from how we protect our mission-critical systems from attack, for example, systems that keep a large natural gas pipeline running, to how to manage cyber risks within the entire enterprise value chain, to how we train our employees not to succumb to phishing attempts.

Jim Feinerman: We shouldn't forget that even large corporations once operated in a major city and had most of their operations there, or maybe in several places across a single country. But now it's the case that even relatively small companies have global risks they have to face. And the pandemic certainly brought that home on the health front, but when you factor in all the other things that are happening globally, including the risks of climate change, it's really mind boggling to think of the things that you might have to consider as a CEO.

Kimberly Simpson: And let's not forget the Foreign Corrupt Practices Act. Companies have to make sure they have a culture overseas that doesn't condone activities that wind up making headlines in the *Wall Street Journal*. It's one more risk factor for boards and CEOs of multinationals to manage.

Audience Member: In light of global crises and risks, how are corporate boards advising management teams to maintain and grow profits without squeezing customers?

Kimberly Simpson: Your question provides a good segue to talk about corporate purpose, about whether companies have obligations beyond growing their profits for shareholders. I try to look at it holistically. For example, "I'm a concrete company. Okay, well, what's my purpose? My purpose is to help people get from one place to the other safely in because I produce materials that pave roads from highways to neighborhoods." It's important to frame your company's business in a purpose-driven way because that's what resonates for consumers and for employees. Within that context, however, there will probably be back-and-forth conversations about what pricing is appropriate, with reasonable voices eventually settling on levels that satisfy profit objectives but don't gouge the customer or overestimate market pricing.

Jim Feinerman: I think that's right. Although two other things come up in that context. One is the idea that there are competing forces within the board. There are people who are thinking about the consumer question while others are thinking about the profitability for shareholders question, and they can come to a consensus, or they can be at loggerheads with regard to what they want to do. And then one of the roles that the CEO has is to find that consensus among board members and management. From the outside, the workings of a corporate board may look like a black box, but there are other human-related factors at work including corporate culture and individual personalities. We often hear negative examples, like the corporate toxic personalities; though they are not numerous, they can really make a dent when they surface. And it also can bankrupt corporations if it's the wrong person at the wrong time.

Bruce Shaw: This is a good point in the discussion to get your takes on something getting a lot of headlines these days, stakeholder capitalism. The late Lynn Stout, once a professor here at Georgetown Law, wrote in her book *The Shareholder Value Myth* that "United States corporate law does not, and never has, required directors of public corporations to maximize either share price or shareholder wealth. To the contrary, as long as boards do not use their power to enrich themselves, the law gives them a wide range of discretion to run public corporations with other goals in mind, including growing the firm, creating quality products, protecting employees, and serving the public interest. Chasing shareholder value is a managerial choice, not a legal requirement." What's your reaction to Professor Stout's rather bold assertion?

Kimberly Simpson: I want to be clear that this is my personal perspective and does not necessarily reflect the views of NACD or our membership. Let's start with the fact that at the end of the day, most public companies are Delaware corporations. Therefore, Delaware law controls, and Delaware is going to say, you have a duty care and a duty of loyalty. And I think what the realization has been, or the thing that we hear more about is that incorporating stakeholders in more corporate decisions can create a virtuous circle. If you've got happy employees, they're going to be more innovative. You're going to stay ahead of the market. If you're well-respected in your community, your consumers are going to buy more from you. They trust your brand. And that more often than not translates into creating more value for your shareholders.

Boards are also reacting to new SEC rules and guidelines regarding ESG reporting and thinking about how to generate profits while being a good steward of the company's resources and considering external stakeholders. They are also fielding new perspectives by leading voices, including annual letters from Blackrock's Larry Fink and a restatement of business purpose from the Business Roundtable. Last but not least, boards attempt to factor in what might change as political administrations change. Finding the right balance takes a lot of thoughts.

Jim Feinerman: One thing I'll add is that we use the metaphor a lot in corporate law teaching about the 35,000-foot perspective of directors. They're not down on the ground, they're not dealing with company issues day in and day out. They effectively helicopter in 4, 5, 6 times a year. And I think a very important point to reiterate is that they're advisory. They're going to say things based on what they believe are best practices and things that the corporation should be doing, but those day-to-day managers and the corporate overseers, they're dealing with the crisis at the moment. They have to do things on the fly. And as a result, you can have the best board in the world with the best sort of guidance and corporate principles, but when the unexpected happens, you recalibrate. It's often not practical, or possible, for day-to-day managers to run real-time decisions by the board.

Kimberly Simpson: I'll add one more observation: the number of public companies in this country is shrinking, and we need to look at why that is. Is it increasing regulation? Is it pressure from activist investors? Is it just easier to operate as a private company? All of these might be contributing, but we can't lose sight of the many benefits of the public company structure in terms of access to capital and resulting innovation, but also because public companies are the primary investment option available to the individual investors looking to invest in business to grow wealth.

Bruce Shaw: Let's shift and talk about ESG next. We read a lot of headlines about ESG and about how companies are prioritizing this umbrella of issues. We also hear about greenwashing and how company actions don't really line up with their ESG talking points. Would you share with us how you see boards or your members translating ESG aspirations into tangible strategies or actions?

Kimberly Simpson: Well, first of all, I hope everybody knows what ESG stands for, "environmental, social, and governance." I don't know how they all got mashed together because they're very different things and cover a huge number of topics. Just take "G" for example, which refers to governance and covers the A to Z about how you run a corporate board. Another challenge is that the "E" in ESG is becoming weaponized. It often drives public controversy, which clouds what it really is and keeps companies from solving real problems – and creates more confusion than clarity. Some of the debates have the potential to further erode society's trust in business more generally.

That said, ESG – and each of its three categories – is really important for board directors right now. Our research shows that 70% of public company boards worked to improve their ESG reporting in the last year, and almost half of them say their biggest challenge is a lack of uniform disclosure standards. For example, compare my concrete company and Alaska Airlines. How are they going to report the same metrics around climate change or other risks that fall under the ESG umbrella? Companies in different industries may want to voluntarily report how E, S, or G factors into their strategies or how they are doing on various fronts, but they also are facing changing public disclosure requirements. Balancing how you communicate meaningful information in this context is challenging. But I'm very encouraged by the uptake I see by public company directors in trying to make sure they're understanding and doing the right thing, asking those right questions when they are coming together.

Bruce Shaw: We also have in our audience Professor Sam Flax. I don't mean to put Professor Flax on the spot, but he teaches an ESG / Corporate Social Responsibility elective here at the Law Center. Professor Flax, is there anything you'd like to add?

Sam Flax: Sure. I'll attempt to put some of this in context, and one reality that companies have to deal with are politicians who take on one side of an ESG or DEI issue because it's a way to attract voters – and could help to secure the next election. Beyond that, businesses compete in a modern world where internet-based news accelerates communication, and social media adds to that and sometimes creates echo chambers. As a result, there is a realization that a corporation can't just be a profit-making entity that only focuses on the bottom line. Bruce mentioned Lynn Stout's book earlier. In my very first class each year, I have my students read that excerpt – and contrast her views with Milton Friedman's famous essay in the New York Times over fifty years ago where he argued that the social purpose of a corporation is to increase its profits within the confines of the law, that is, its obligations are principally to its stockholders.

In 2023, there is a growing awareness of the corporation's responsibilities for its externalities, whether it's just the right thing to do, or whether it's a recognition that its constituencies are far broader than the stockholder. When it comes to disclosure on ESG and corporate social responsibility matters, the Europeans are far ahead of us in the United States. And if the U.S. doesn't get its act together on reporting and disclosure matters, we'll most likely end up following whatever standards the Europeans set, like it or not.

Kimberly Simpson: To briefly touch on DEI issues – and again this is me talking, not NACD – there are usually corporate rationales for doing the right thing in the various areas DEI covers, and it's important to articulate them. For example, we say its socially important that we have an inclusive society, but from a corporate perspective, why would you want to have diverse people in the boardroom? Well, let's think about this. You have a compensation or human capital committee that looks at the whole company top to bottom. Now, they're not setting pay for the frontline workers necessarily, but they're looking at the zeitgeist of the company. It stands to reason that you'll probably have a better functioning committee if you have people on that committee that reflect the makeup of the workforce, as they could understand the needs of that workforce. Or the company is talking about going into a new market, and in the new market, the customer happens to be female. You're selling your product to women in this new market – so from a strategy perspective, it might be valuable around the table to have female voices to provide feedback or ask the right questions to guide the strategy. And that's what it's all about. From a business perspective, it’s just good for the bottom line – for the price of the stock. We've still got a long way to go, but we're getting better.

Sam Flax: I would just add one thing on that – and this is sort of a Georgetown plug – probably the best article out there on the intellectual basis for diversity on boards is by Chris Brummer published last year in Vanderbilt's Law Review, and co-authored with Leo Strine, the former Chief Justice in Delaware. It makes a very strong argument in traditional Delaware fiduciary duty terms -- duty of care, particularly duty of loyalty -- for diversity. The article also has extensive discussion about what the authors call the need for cognitive diversity on boards. I’d really recommend the Brummer and Strine article for anyone wanting to dig deeper in this area.

Bruce Shaw: Thanks Sam. Another issue that we see in the headlines quite a bit is CEO pay. It’s too high in absolute dollar terms, and maybe worse in light of its ratio to the pay of the average worker. Kimberly, what are you hearing from your members on this?

Kimberly Simpson: So, let’s back up, and remember that during the Sarbanes-Oxley reforms, one new reporting requirement was for companies to disclose the ratio of CEO pay to that of the average worker at the company. It’s also important to keep in mind that boards use public data to justify CEO pay levels; for example, the compensation committee will approve a group of peer companies selected by their compensation consultant, and each year, it will review how its CEO compensation compares to that of the peer group. Companies are stuck in between the headlines on high CEO pay and the reality of the market-driven forces that set those pay levels. We are seeing innovations like how companies are measuring CEO performance and how non-cash compensation is vested, but so far, CEOs still command a lot of compensation. As I said earlier, CEOs with the right skill sets do not grow on trees.

Jim Feinerman: I’d like to add two things: one, there's a whole cottage industry of compensation consultants. And to the extent that this is seen as almost a conspiracy to make sure that we keep pay in a certain range because we're all consulting the same people about what CEO and other senior officer pay should be. And of course, they have no interest in low balling, though they do have an interest in being within a fair range. But I think it's really created a kind of vicious circle because the next person who comes up for a similar CEO job or a similar kind of company, what do we expect the compensation consultant say? The market says this particular CEO should be paid in this range.

The second thing is that the attempt to insulate oneself from the typical process by getting input from other advisors doesn't always work as advertised. For example, going to an investment bank like Morgan Stanley or Goldman Sachs and asking for their arm's length independent valuation for what this post should be paid. However, this has its own complications. Bankers are always thinking about the next deal, and so their advice may not be completely relied on as objective. I don't want to say that it's a totally rigged game, but at the same time, the processes in place are far from perfect.

Bruce Shaw: Thank you, Kimberly and Jim for fielding all our questions this afternoon, and I want to also extend a thank you to Sam Flax for sitting in and sharing his insights. We covered a lot of ground, and I look forward to the next chance we have to compare notes. Last but not least, thanks to all of you for attending – and very best wishes on the remainder of the semester!