Should Directors Meet With Shareholders?

If circumstances call for such a meeting, here are several suggestions for maximizing the usefulness of this session.

by Michael A. Miles

An important question confronting chief executives, boards of directors, and institutional shareholders is whether nonexecutive directors should meet with the institutional shareholders. My view can be stated unequivocally in two words: "Yes, but...."

The "yes" part is fairly obvious. Shareholders are, after all, the owners of the company and are the "bosses" to whom the directors are accountable. As such, shareholders – and I believe that includes all shareholders – have the right to meet with whomever they have a *legitimate reason* to meet with – be it the CEO, other members of senior management, or the directors of the company.

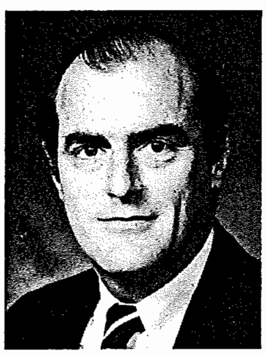
The "but" part is also fairly obvious. Primarily because of the nature of the role of all nonexecutive directors, there are certain circumstances and conditions that should exist to warrant such meetings and make them useful for all concerned – absent which I would suggest such meetings should *not* take place.

The first condition is that there be a specific, significant reason for the meeting, such as a major question, or complaint, relating to overall corporate strategy, performance, or corporate governance. Without such a specific "global" corporate issue, I do not think director/shareholder meetings are a good idea, for reasons I will address below.

The second condition for a director/shareholder meeting is that it should take place only when more traditional channels of communication have been tried and deemed to have failed.

In general, most shareholder communication starts and ends with the investor relations department. But, in the case of institutional and very large individual holders, it is now not unusual for there to be direct communication with more senior management as well.

In a survey done by *Institutional Investor*, 90% of the companies surveyed claimed to engage in formal, direct communication between top management and institutional shareholders, with 80% claiming CEO involvement in the process and 94% saying the CFO participated in such communication. Ninety-one percent of the companies said they maintained both formal and informal commun-



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ication with institutional shareholders, and 75% said investor relations were either very important or extremely important to them. If these findings are representative, it appears that the normal communication channels between institutional shareholders and corporate America are quite open and one would assume that most shareholder questions, comments, and/or complaints could be addressed in a normal fashion.

In rare circumstances, however, shareholders will want to see directors. I note that these are rare circumstances because, while we know it does happen, the Council of Institutional Investors, for example, has only asked for such meetings on two occasions in 10 years. While there have certainly been other requests from other quarters, I think that still qualifies as rare.

However, assuming the time has come for a meeting with outside directors, I would suggest several ways to maximize the usefulness of such a session.

The Right Directors

First, because it is often very difficult to get all outside directors together on relatively short notice, I would suggest focusing attention on those directors whose roles are most relevant to the issues at hand. If the subject of the meeting is corporate performance and/or executive compensation, I would seek to meet with the members of the compensation committee. If the subject relates to corporate governance, I would want to meet with the nominating committee or committee on directors. If you think someone has a hand in the till, I would contact the audit committee...and so on. And if the company has a nonexecutive chairman or a lead director, I would want that individual in the meeting whatever the subject.

For as long as you want to maintain a constructive dialogue with outside directors, you should not preview – or review – your meetings with them in the press.

Second, except in very rare circumstances of suspected management malfeasance or corruption, I would have the CEO attend the meeting. The CEO is the one individual most directly responsible for the company's operations and performance, and should be included in the meeting to answer questions that come up and to address concerns that are raised. To ask for outside directors to exclude the CEO from such meetings places them in the very difficult position of "going behind the CEO's back." It also leaves them at the end of the meeting wondering if they've heard both sides of the story or only one. Thus, for the best, fastest, and perceived to be the fairest communication, it is best to have the CEO at the meeting.

Statement of Purpose

My third suggestion is that, prior to the meeting, one should provide the outside directors with as clear a statement as possible of the subject, purpose, and desired agenda of the meeting, as well as with any background materials that will help them prepare for it. In so doing, you will both offset concerns that the meeting is some kind of enemy ambush and increase the likelihood that directors will come better prepared to ask questions and discuss the issues at hand.

My fourth suggestion is that while you should not expect any decisions during a meeting with outside directors (especially if not all the directors are present), you should expect some response from the board sometime after the meeting. You should expect that response on a timely basis and you should make that expectation clear at the conclusion of that meeting.

At this stage of the game, it would be only a very dense set of corporate managers and directors who would fail to respond in some way to an issue raised at the kind of meeting that is being suggested. But, while recognizing that confidentiality may prevent a company's giving a complete and detailed explanation of certain corporate actions, a shareholder will probably not be satisfied with a "Gee, thanks for coming, we'll think about it" response in any set of circumstances, and that should be made clear to all concerned.

No Ultimata

My fifth suggestion is that for as long as you want to maintain a constructive dialogue with outside directors, you should not preview – or review – your meetings with them in the press. Outside directors do not like to read, in advance, about ultimata to be delivered to them, and they do not like to read later about their perceived insensitivity or incompetence. Thus, they will not want to read in advance that they have been summoned to a meeting where you will demand that they do X, Y, or Z, and they will not like a media review of the meeting that says that they are nothing but management cronies or "yes" persons.

Remember too, that they all read the business press, and if you develop a reputation for assisting in ambush journalism, your reputation will precede you across corporate America and will impede your ability to get directors to meet with you. So, unless you are prepared to play hardball from the outset and be known for doing so, don't play your case in the press until all else has failed.

The last suggestion is perhaps the most obvious of all. Don't have a meeting like this unless everyone's lawyers are sure that it is in compliance with everything.

When Not to Meet

Now, having addressed the circumstances when director/shareholder meetings should be held, here are two specific circumstances when I think they *should not* be held.

The first is *when there is no significant issue at hand.* In recommending this, I realize I am in disagreement with corporate governance gurus who advocate having what I'll call "getting to know each other better" meetings between institutional shareholders and corporate boards of directors.

My own view is that if everyone is satisfied with a company's performance and prospects so that there are no major questions or complaints on the table, then there is little value – and real potential for inventing trouble – in having a general, unfocused, let's-just-get-together-and-talk meeting between institutional investors and directors.

In my experience, most key players on both sides are too busy for such meetings. All too frequently, such meetings lead to unproductive follow-up work simply so that the meeting can be said to have produced something. In the worst case, such meetings have the potential to invent solutions for which there are no problems.

The second circumstance in which I would not have a meeting is where *one, or at most two, unsuccessful meetings on the same subject have already gone before.* If two previous meetings haven't gotten anywhere, then I believe that it is very unlikely that two more – or 22 more for that matter – will get anywhere either. When a company won't or can't adopt a shareholder's strongly recommended course of action, then any more than two meetings on the same subject results in more harm than good: it polarizes the parties and simply intensifies an already adversarial atmosphere.

The Key Checklist

To sum up, should outside directors meet with shareholders? The answer is yes, because shareholders are directors' bosses and should be able to meet if they want to meet. But, I do believe there are "buts" and mine are as follows:

1. There should be an important, specific director-level reason for the meeting.
2. The meeting should be requested only when the regular channels of communication have been exhausted.
3. Since it is often very difficult to get all outside directors together at once, it is best to focus on the most relevant sub-group: compensation committee, audit committee, nominating committee, or the like.
4. Unless there is a very real reason not to, it is best invite the CEO.
5. It will help to provide attendees with homework materials in advance so that they come prepared.
6. Don't look for instant decisions in a meeting, but do insist on appropriate follow up.
7. Unless and until you want to play hardball and get a reputation for same, don't preview or review your grievances in the press.
8. Be careful to observe all the legalisms.
9. If one or at most two meetings have not been productive, don't expect that any more will be either.

While you may have arrived at some of this advice already, I hope these views on director/shareholder meetings will be useful in guiding your course of action in this important and sensitive aspect of corporate governance. ■

If everyone is satisfied with a company's performance and prospects, then there is very little value in having a general lets-get-together-and-talk meeting.