2020

Boards in Information Governance (blog)

Sarah C. Haan

Faith Stevelman
New York Law School, faith.stevelman@nyls.edu

Boards in Information Governance

By Sarah C. Haan and Faith Stevelman April 10, 2020

1 Comment

When the markets go haywire, as they appear to be doing now, stock prices cease to provide useful signals about corporate value or the performance of the men and women in the C-suite. This is a major problem for the agency-cost theory of corporate governance, which has given us the so-called "monitoring board." In what is now the dominant theory of corporate governance, the monitoring board sits atop the corporation and safeguards the value-creating work of executives primarily by monitoring changes in the company's stock price. With its primary mandate of securing shareholder profit, the monitoring board exercises a limited set of tasks. It reviews CEO performance and executive pay, mainly through stock price metrics. It umpires the firm's extraordinary transactions, again primarily with reference to stock prices. And it scrutinizes potential acts of self-dealing. That's about it.

The monitoring-board governance model suits hierarchical and mostly static organizations, where tasks and challenges can be put mostly into silos, warranting little genuine strategizing at the top. But this is the kind of organization more representative of 20th century manufacturing firms than 21st century asset-light, globalized, and technologically sophisticated companies. In the name of efficiency, 20th century corporate governance trimmed the board's mandate to the bone, masking the high stakes of what true corporate *governance* might mean and require. Doing so also lightened the board's workload, enabling an insular cohort of directors to serve on multiple big-company boards.

America's decades-long experiment with the monitoring board may be coming to an end. With the benefit of hindsight, we can acknowledge it now as a failure – an abnegation of private sector leadership. Boards trained to watch rising stock prices did not prepare for, or perhaps even see, emerging threats to economic success and prosperity. Now, when stock prices fail as performance metrics, boards cannot merely sit back and wait for the CEO to tell them what information they should rely on. Information governance is pro-active, board-level governance of complex knowledge and communications networks, mandating reformulation of what it means, in the 21st century, to "manage" or "direct" a corporation under Delaware General Corporation Law §141.

Even before the coronavirus pandemic, boards were being presented with novel, pressing demands that included disruptive hedge fund activism and serious, widespread expectations of environmental, social, and governance ("ESG") stewardship. The pandemic and its associated market turbulence have heightened both sets of demands, while removing stock prices as heuristics for determining whether the C-Suite is doing a good job. In the near future, we will see hedge funds, including vulture investors, swoop in as firms stumble, and many are stumbling, while stakeholder demands intensify. The monitoring board has left public companies without deliberative strategizing at the highest level.

So what will replace it?

In a forthcoming article, we posit that the future of board governance lies in the strategic management and authoritative deployment of information. This thesis isn't a distillation of platitudes and jargon: It describes a fundamental change from the agency-cost, monitoring board model. Moreover, as firms are scrambling to email customers and revise employment policies, the global pandemic and stock market crash are accelerating this information and communications-based evolution in corporate governance.

To weather the pandemic and crash, boards of directors will need to engage fully with top management to marshal their firms' human and capital resources and direct them to their highest and best use. Firms that took their stakeholder and risk management obligations seriously, and boards that fully embraced the lessons of *Caremark*, are the ones poised to make the strongest recovery. They will have built the necessary infrastructure and followed best practices for deliberation and communication.

But there is more to the future of board governance than *Caremark* duties.

The new reality of hands-on, informational governance is evident already in how technology has altered the practice of shareholder meetings, board-level information exchange, and corporate disclosures. Especially as we observe the migration to virtual shareholder meetings, we are seeing the best boards immerse themselves in newly upgraded information and communications environments. They are working not merely to synthesize the most current data in order to envision next steps, along with their CEOs, but to communicate crucial information to the firm's important constituencies.

We are seeing an immense, newly robust recognition that corporate success depends on express engagement not only with investors, but with employees and customers. The best boards had already been moving from the stale monitoring board model and had been putting into place enhanced internal and external communication processes. Doing so recognizes that the new economy rests at least as much on cutting-edge information management as on conventional capital resource deployment. This sort of knowledge and communications-based management is more judgment-based governance than stock-price dependent governance. The emphasis on human, board-level judgment is also a rejection of futuristic takes on passive, techno-governance based on algorithms, presented as if humans were just along for the ride in "self-driving" corporations. As complements to information technology, human judgment will prove crucial to superior strategizing.

We expect a transition to more technology-enabled boards whose members bring informational and communicative strengths. Directors will serve on fewer boards, because it's hard to do informational governance right at several firms at once. We hope that the current shocks will open the door to younger and otherwise more diverse board members, highlighting their value in revitalizing corporate leadership. Professional advisers – lawyers, investment bankers, and technologists – will play an important, adjunct role, but directors will be positioned to actually lead, for the first time in decades.

This post comes to us from professors Sarah C. Haan at Washington and Lee University School of Law and Faith Stevelman at New York Law School. It is based on an article forthcoming in the University of Pennsylvania Journal of Business Law and available here.

1 Comment

James R. Doty

Brilliant—more specialization of committee skills to support the engagement at various levels with employees and customers, more frequent use of "task force" approaches to problem foresight and solution-vetting. Delegation issues have to be rethought.

April 10, 2020 at 10:52 am

Reply | Report Comment

Leave a Reply

Your email address will not be published. Required fields are marked *

Comment

Name *

Email *

Post Comment