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Fair Game

Too Many 'No' Votes to Be Ignored

By GRETCHEN MORGENSON

ARE the days of the cocooned corporate director finally coming to an end? One can only hope. Even though directors — through the boards they sit on and the various committees they oversee — are supposed to keep wayward or incompetent chief executives at bay, all too often they are, in practice, just cronies of management.

For years, shareholders have done little to voice complaints about such cozy relationships, but it seems that the financial fiasco of the last few years, and the lackadaisical performance by directors at major banks that contributed to the meltdown, is encouraging investors to become more vocal.

Signs of such a welcome development can be seen in the results of this year's director elections at annual corporate meetings. According to an early assessment of these shindigs, shareholders voiced significantly greater opposition to directors who were up for election this year than they did in 2008. Although such "no" votes aren't binding, they send a powerful message that should reverberate throughout corporate board rooms.

An analysis of 2,441 shareholder meetings where voting results were available through the end of August shows that 9.8 percent of directors running unopposed for election failed to receive support from at least 20 percent of the shares voted. In all of 2008, only 5.5 percent of such directors attracted this level of opposition from investors.

Even with such thumbs-downs nearly doubling year-over-year, negative votes on directors still remain relatively small and suggest that investors have plenty of room for improvement if they want to make themselves heard.

The study, conducted by Proxy Governance, a shareholder advisory firm, showed that the percentage of directors experiencing even greater opposition — at least 40 percent of shares voted — also rose sharply in

2009. That group was 2.1 percent of the sample, up from 1 percent during all of 2008.

A total of 84 directors, or 0.6 percent of the sample, failed to get support from a majority of shares cast in 2009, the study showed. During 2008, such board members accounted for only 0.2 percent of the full-year sample. A PDF of the study is on Proxy Governance's Web site at bit.ly/2lJjbp.

Investors are clearly angry with their companies, and they have their reasons. Director accountability to the shareholders they are supposed to serve has been sorely lacking for decades. Even as they rubber stamp risky corporate practices and excessive executive pay, directors continue to win re-election to their increasingly lucrative board seats.

Because it is so difficult for shareholders to force directors out — proposing an alternate slate of directors is mighty expensive, and board members can win seats with only one "yes" vote — corporate elections remain a sham. Still, the throw-the-bums-out message from shareholders withholding their support for directors is coming through loud and clear.

Scott Fenn, senior managing director for policy at Proxy Governance, says the findings show how frustrated investors are about the immense losses they took in the financial crisis. "More institutions are now using votes against directors or 'withhold' votes as a primary means for holding boards accountable," he said. "Large institutions were less willing to give directors the benefit of the doubt."

It is interesting that this year's shareholder opposition does not appear to be the result of organized "vote no" campaigns. Mr. Fenn said there were 27 such movements in 2008 and only 10 that he is aware of this year. So the shareholder anger appears to be organic.

Digging deeper into the data, Mr. Fenn identified specific areas of concern for shareholders. Executive compensation was an obvious one, but related-party transactions among directors also seemed to anger company owners. Directors at companies that recently instituted or renewed antitakeover measures — known as poison pills — also got slapped by investors.

Which companies met with the greatest hostility from their owners? Proxy Governance identified four directors

at the Shaw Group, an engineering and construction company, who received opposition from 44 percent of votes cast and four directors at Convergys, an information management company, who got rejection slips from at least 40 percent of the votes cast. At Crown Holdings, a packaging company, three directors received “withhold” votes from more than 36 percent of the shares.

Note well: These and other iffy election results would probably have been far more extreme under a rule taking effect next year. Brokerage firms will no longer be allowed to vote the shares of clients who haven’t provided instructions in director elections. Since brokers control up to 20 percent of the vote at many companies and routinely side with management’s recommendations, abolishing this practice will increase pressure on directors who do not do their jobs properly.

FREDERICK E. ROWE, a money manager in Dallas who is president of Investors for Director Accountability, a nonprofit shareholder advocacy group, urged investors to keep the heat on their companies’ boards.

“Directors are the legal representatives of company owners and are responsible for imparting the essential influence of ownership,” he said. “But their role has been completely marginalized as chief executives have usurped more and more power.”

Mr. Rowe said investors must force directors to slash the “friction” costs that drain their companies’ coffers and diminish investment returns. “Friction takes the form of fees and costs generated by Wall Street, excessive compensation paid to company managements and all their helpers, finders’ fees for placing money, and political contributions to keep the wheels of commerce greased,” he said.

How expensive is this friction? Mr. Rowe estimates that the excess costs associated with management compensation, Wall Street fees and political expenditures by corporations reduce investor returns about 3 percent on average every year. Given that there is $10 trillion in retirement savings now invested in the stock market, pretty soon you’re talking real money.

Consider this calculation: If the stock market generates average annual returns of 8 percent over time, in 30 years that $10 trillion would have grown to more than $100 trillion. But shave 3 percent off those returns and shareholders are left with just about $40 trillion. Almost $60 trillion gets diverted.

"We have drastically underfunded pensions across the country, and individuals are not making the returns they need to retire comfortably," said Mr. Rowe. "Management and Wall Street are working together to drain that savings pool. If directors made sure that managements were incentivized for the long term instead of the yield-to-bonus mentality that nearly broke us, investors can recapture the returns that are ours."

It is unfortunate that the only way to force some directors to live up to their duties is for shareholders to keep them worried about an embarrassing vote. But since that is the only weapon investors have, it's gratifying that more of them seem ready to rumble.

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