BENCHMARKING BOARDS OF DIRECTORS FOR BETTER CORPORATE GOVERNANCE

Hugh Grove *, Mac Clouse **, Tracy Xu ***

* School of Accountancy, University of Denver, the USA
** Reiman School of Finance, University of Denver, the USA
*** *Corresponding author*, Reiman School of Finance, University of Denver, the USA
Contact details: Reiman School of Finance, University of Denver, 2101 S. University Blvd., Denver, CO 80210, the USA

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Abstract

The key question and major lessons learned in this research are that individual companies and their boards of directors could use the board director benchmarking information compiled in the Conference Board Report to assess their own boards of directors' corporate governance practices. For an initial benchmarking approach, this paper compared a poor long-term market performance company (Grove & Clouse, 2019) with a strong long-term market performance company (Grove & Lockhart, 2019). The following benchmarked differences in the boards of directors of these two companies were key success factors for constellation: specific industry knowledge, younger directors, coaching/nurturing, involved roles, long-term compensation of directors, no board entrenchment, board assessment, and board committee rotation. The major sections of this paper are literature review, corporate board practices, benchmarking board of directors: poor long-term market performance example, benchmarking board of directors: strong long-term market performance example, conclusions, and future research. A major limitation of this paper, which could be investigated in future research, is to analyze benchmarked board categories to see if they help explain differences in comparative long-term market performances by many companies since companies and their markets are diverse.

Keywords: Benchmarking Boards of Directors, Corporate Governance

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1. INTRODUCTION

On April 24, 2019, The Conference Board, a non-profit business membership and research group organization, and Esgauge, a data mining firm focusing upon environmental, social, and governance (ESG) practices, jointly published the 2019 edition of Corporate Board Practices in the Russell 3000 and S&P 500 in collaboration with a law firm, a global leadership advisory firm, and the Weinberg Center for Corporate Governance. This report was based upon a comprehensive review of the U.S. Securities and Exchange Commission (SEC) 2018 required filings on the SEC EDGAR database by 2,854 companies registered with the SEC and listed on the Russell 3000 Index. This data was compared to similar data from the S&P 500 companies. This report's findings illustrated the state of board

practices with major observations and a related benchmarking analysis (The Conference Board, 2019) which will all be discussed in the third section, Corporate Board Practices, of this paper.

The key question and major lessons learned in this research are that individual companies and their boards of directors could use the board director benchmarking information compiled in the Conference Board Report to assess their own boards of directors' corporate governance practices. For an initial benchmarking approach, this paper compared a poor long-term market performance company (Grove & Clouse, 2019) with a strong long-term market performance company (Grove & Lockhart, 2019). The following benchmarked differences in the boards of directors of these two companies were key success factors for constellation: specific industry knowledge, younger directors, coaching/nurturing, involved roles, long-term compensation of directors, no board entrenchment, board assessment, and board committee rotation.

Exploring the benchmarking of boards of directors, the major sections of this paper are literature review, corporate board practices, benchmarking board of directors: poor long-term market performance example, benchmarking board of directors: strong long-term market performance example, conclusions, and future research. A major limitation of this paper, which could be investigated in future research, is to analyze all these benchmarked board categories to see if they help explain differences in comparative long-term market performances by many companies with their different boards and corporate governance practices, not just the two companies analyzed in this study.

2. LITERATURE REVIEW

The topic of corporate board practices has been researched in the literature in various studies which can be used for benchmarking comparisons. For example, Pichet (2017) advanced a better definition of an independent director which improved the understanding of the roles he(she) fulfills on boards of directors. An ideal independent director was defined by outlining the objective qualities that are necessary and adding those subjective aspects that have turned this into a veritable profession. An ideal process for selecting independent directors was defined, based on nominating committees that should themselves be independent. Also, ways of assessing directors and renewing their mandates are included.

Reguera-Alvarado and Bravo Urquiza (2016) analyzed whether the number of appointments of directors influenced corporate reputation. 30,813 U.S. directors on public firms were examined from 2007-2010. They found a curvilinear relationship between the number of directorships of board members and corporate reputation. Their results shed some light on the value of boards and have implications for companies in the selection of board members.

Previous literature found mixed evidence on the relationship between board size and company performance. Alabdullah, Yahya, Nor, and Majeed (2016) studied the structure of the board of directors and its effects on the financial performance in terms of financial leverage of 109 Jordanian companies in the year 2011. They found that the corporate governance mechanisms, such as increasing the board size, had a positive effect on reducing the level of financial leverage, thus leading to enhanced levels of financial performance. However, Yermack (1996) showed an inverse association between board size and firm value. One interpretation is that problems of coordination and communication might hinder firm performance when the board size increases. In addition, executive turnover was found to significantly moderate the relationship between board size and financial leverage.

The minimum number of independent directors has also been studied in relation to corporate performance in China. The Chinese Securities Regulatory Commission issued a regulation stipulating a minimum number of independent directors on corporate boards in 2001. Using a sample of 22,646 firm-year observations from 2001 to 2003, both state-owned (SOE) and non-state-owned firms improved their board independence significantly and both types of firms increased their performance significantly in the post-regulation period with SOE firms having a greater increase in performance (Bhabra & Li, 2011).

Another research study explored the role of independent directors in CEO supervision and turnover. The authors believed that correct CEO supervision can only be effectively undertaken if the independent directors truly have the personal quality of effective independence. Companies with a larger number of effective independent directors were more likely to replace a CEO when performance was not as expected (Stein & Plaza, 2011).

Another independence issue was studied concerning the role of independent directors on the audit committee. Survey respondents agreed that the external auditor would be more effective and independent if the audit committee assumed the responsibility to appoint the auditor, determine and review the audit fees, and determine and review the external auditor's scope and duties. Such roles would enhance the perceptions of users of financial statements concerning the effectiveness of the audit committee (Sori, Hamid, Saad, & Evans, 2008).

In contrast, Adams (2017) argued for the irrelevance of board independence. There was no convincing evidence that greater board independence correlates with better firm performance. He raised several concerns about analyzing board independence, including difficulties to measure truly independent directors and difficulties to disentangle the causal effects of independence from the effects of other factors.

The topic of busy directors was explored in a sample of 893 diversifying acquisitions from 1998 to 2004. Busy directors were found to be negatively associated with the five-day cumulative abnormal returns in acquisitions involving public targets where merger-related agency problems are more likely. In the case of diversifying acquisitions, increased managerial monitoring played a more important role versus enhanced advising and business connections from busy directors (Chen, Barry Lin, & Yi, 2008). Another study examined the

technostructure gap in the educational qualifications of executive and non-executive directors. Significant differences and divergences were found, especially in relevance to the company's operations. Disadvantages from potentially sub-optimal technical information flow were also discussed (Phillips & Cotter, 2010).

For an example of a benchmarking consortium to help identify best board practices, the approach used by Bocconi University in Milan is provided. Bocconi had developed a Benchmarking Consortium of approximately 35 global companies operating in the European Union. They met quarterly at Bocconi for benchmarking presentations and for sharing benchmarking experiences, including subsequent site visits if desired. They also shared operational data for benchmarking purposes. A major application was the shared development of accounting transaction costs in order to assess operational efficiency for the cost per transaction. The data was then graphed on two dimensions: centralized versus decentralized accounting departments and complex versus simple product lines. The lowest cost per accounting transaction by far was the combination of centralized accounting with simple product lines versus the highest cost per accounting transaction of decentralized accounting with complex product lines. There were consortium discussions of related benchmarking strategies for accounting operations and subsequent site visits as requested. Thus, this benchmarking approach was more extensive than just accessing a subscription benchmarking database (Beretta, Dossi, & Grove, 1998).

Guidelines for independent and competent board directors have been developed from reviews of research and from company examples. Directors must have no material relationships with the company over the past year. Directors should have business savvy, a shareholder orientation, and a genuine interest in the company. Concerning directors' compensation, they should be paid for performance, not presence, with a mix of short and long-term performance measures, such as a three-year period for both stock market price and financial accounting performance. If a company performs poorly, compared to its peers over this period, claw-back provisions should be invoked for board members' compensation. There should be a mix of skills for board members, such as industry knowledge, experience, and expertise in financial accounting, risk management, and cybersecurity. There should be term and age limits and a minimum number of women on boards (Grove & Clouse, 2015).

As an additional guideline for independent and competent board directors, they are encouraged to develop more wisdom in order to assess emerging threats, challenges, and opportunities. Such wisdom is needed with the perspective of the public corporation as separate legal personhood, as advocated by the European Parliament's Committee on Legal Affairs in 2015, versus just a shareholder focus or a stakeholder focus. The rapid increase in the development of artificial intelligence and other technologies has tremendous significance for board directors' contributions to effective corporate governance. To facilitate the development and evolution of the public corporation into separate legal personhood, board directors need wisdom for more effective corporate governance in these challenging times. This key success factor of wisdom for board directors can be assessed with the well-established three-dimensional wisdom scale (Grove & Lockhart, 2019)

3. CORPORATE BOARD PRACTICES

The findings of 2019 Conference Board report illustrated the state of board practices with nine major observations:

- Despite demand for more diversity and refreshment, 50% of the Russell 3000 companies and 43% of the S&P 500 companies reported no change in board composition. When a change did occur, it rarely affected more than one board seat.
- Directors are in for a long ride; their average tenure exceeds ten years. 25% of the Russell 3000 directors step down only after more than 15 years of service.
- Despite the demand for more inclusiveness and a diverse array of skills, companies continue to value prior board experience in their director selection. Only 25% of these companies elect a director who has never served on a public board before.
- Corporate boards remain quite inaccessible to younger generations of business leaders, with the highest number of directors under age 60 seen in new economy sectors, such as information technology and communication services. Only 10% of Russell 3000 directors and 6% of S&P 500 directors are aged 50 or younger while in both groups 20% of board members are more than 70 years of age.
- While progress on gender diversity of corporate directors is being reported, a staggering 20% of the Russell 3000 companies still have no female board representatives. Only 4% of Russell 3000 companies have a female board chairperson.
- Periodically evaluating director performance is critical to a more meritocratic and dynamic boardroom. Even though many board members of Russell 3000 companies consider the performance of at least one fellow director as suboptimal, only 14% of these companies disclose that individual directors are reviewed annually.
- Among smaller companies, staggered board structures also stand in the way of change. 60% of firms with revenue under $1 billion continue to retain a classified board and hold annual elections only for one class of their directors, i.e. staggered board elections.
- Though declining in popularity, a simple plurality voting standard remains prevalent. This voting standard allows incumbents in uncontested elections to be re-elected to the board even if a majority of the shares were voted against them. 52% of Russell 3000 companies retain plurality voting for directors.
- Only 16% of the Russell 3000 companies have adopted some type of proxy access bylaws. Such bylaws allow qualified shareholders to include their own director nominees on the proxy ballot, alongside candidates proposed by management.

One corporate governance expert observed: "The accelerating challenges faced by businesses are going to require a significant change in board composition over the next five years. Many industries and sectors lack directors with current skills in key areas such as digital transformation. Additionally, many other boards lack enough directors who are working senior executives and professionals with current, relevant knowledge as to the pace of change in business and the impact of overall business transformation" (The Conference Board, 2019).

This Conference Board report also included a related benchmarking analysis of nine board characteristics which board directors could use to compare with their own boards as follows:

- Board size: Although companies with smaller boards are shown to generate better shareholder returns, most large corporations of necessity have boards with 12 or more members. The median board size of Russell 3000 companies is 9 directors, compared to 12 in S&P 500 companies. Only 13% of Russell 3000 companies have 12 or more directors, compared to 33% of S&P 500 companies.
- Board refreshment: Despite increased demand for more diversity and refreshment, about half of both Russell 3000 and S&P 500 companies disclosed no changes in their board of directors' composition. Director retirement seems to be the only relevant factor and it rarely affects more than one board seat in a single year. About 33% of Russell 3000 and S&P 500 companies added one new director or replaced one in the previous 12 months, whereas only 13% of Russell 3000 and 17% of S&P 500 companies had two new directors.
- Board meetings frequency: Most boards meet fewer than 8 times per year, but specific circumstances, such as CEO succession or crisis management required some boards to hold more than 12 meetings in a 12-month period. The financial sector reported the highest share of companies that held more than 12 meetings in 2018 at 18% versus 7% in the consumer staples sector and 5% among industrials companies.
- Board committees (compensation and nominating/governance): A small number of companies chose to rely on exemptions from listing requirements on board committees, and either combine compensation and nominating/governance committees (about 1% of Russell 3000 and 2% of S&P 500 companies) or do without a nominating/ governance committee (about 5% of the Russell 3000 and 2% of the S&P 500 companies). Also, about 1% of the Russell 3000 and 2% of the S&P 500 companies do not have compensation committees.
- Board committees (risk and audit): Risk committees are the most common, by far, among financial companies, which are subject to the mandatory requirement of the Dodd-Frank Act. The higher a financial company's asset value, the more likely it is to have a risk committee. 76% of firms with assets of $110 billion or more have a risk committee versus only 19% of firms with assets under $10 billion. 38% of Russell 3000 companies in the financial sector have a risk committee. Audit committees continue to be the busiest, as their role needs to adapt to new challenges prompted by data privacy, cybersecurity, and financial risk oversight. Audit committees of S&P 500 companies are the busiest, meeting as many as 8 to 9 times per year with the median being 12 in the largest financial companies.
- Board committee rotation: A large majority of companies still believe that the most efficient process is for the board to reassess annually whether the membership and leadership of its committees remain adequate. Only 13% of Russell 3000 companies and 21% of S&P 500 companies have a policy on the rotation of board committee members. Of these 13% Russell 3000 companies, 72% expect board committee members to rotate every 5 terms, typically after 5 years. Committee chair rotation policies are even more infrequent.
- Board leadership (duality model): While larger companies continue to combine CEO and board chair positions, new economy business sectors, such as information technology and communication services, are more open to nonexecutive board leadership. S&P 500 companies continue to use this duality model of board leadership (53% in 2018 versus 50% in 2016) while only 39% of the Russell 3000 companies combine these positions of CEO and board chair. Only 36% of information technology companies and only 36% of communication services companies use this duality model. Companies using the duality model typically cite the CEO's industry-specific experience and knowledge of the day-to-day firm operations while companies not using this duality model see opportunities resulting from having access to two highly qualified top leaders.
- Board leadership (lead director): The appointment of a lead director has become a common practice for corporate boards, and even some boards with non-CEO chairs adopt it to further strengthen the independence of their leadership. 67% of the Russell 3000 companies have adopted a policy for the appointment of a lead (or presiding) independent director to the board, as have 93% of companies with annual revenues of $20 billion or more. Lead directors' critical tasks include calling and chairing executive board session (79% of consumer staples companies) and acting as a liaison between nonexecutive directors and senior management (69% of Russell 3000 companies).
- Board assessment: Amid institutional investors' demands for meaningful director evaluation and board refreshment, annual performance assessment has become a widespread practice among all but smaller companies. 95% of the S&P 500 companies and 80% of the Russell 3000 companies conduct an annual performance assessment of the full board of directors. At the committee level, 93% of the S&P 500 companies and 77% of the Russell 3000 companies also do annual assessments, but in 80% of the Russell 3000 cases, the assessment is based upon self-evaluations. Board members consider the performance of at least one fellow director as suboptimal, but an institutionalized annual process for the assessment of individual directors continues to remain far less prevalent, even among larger companies. Only 3% of the Russell 3000 and 8% of the S&P 500 companies hire an independent third-party assessor to evaluate director and board performance.

4. BENCHMARKING BOARD OF DIRECTORS: POOR LONG-TERM MARKET PERFORMANCE EXAMPLE

L Brands, a United States company, is a women's intimate, personal care, and beauty retailer mainly operating under the Victoria's Secret, Pink, and Bath & Body Works brands. Its common stock performance was lower than the market as a whole (S&P 500 and Russell 3000 indexes) by a substantial margin over the last one, three, and five-year periods, being negative at 32.1%, 63.1% and 36.7%, respectively, versus positive returns for both major indexes over all three of these periods. L Brand's common stock price plummeted from an all-time high of $100.22 on November 4, 2015 to $26.81 on March 5, 2019, the date when the activist investor, Barington Capital Group, released a negative letter about L Brands. By the end of 2019, L Brand's stock price had fallen to $17.75 (an 82% decrease over the last four years) and its total market capitalization loss was $23 billion, with over 40% of that loss occurring in 2018. The L Brands CEO letter in response to Barington's letter was very defensive and non-corrective.

Based on this very poor company performance, the Conference Board benchmarking results by its major categories will be used to compare with L Brand's corporate governance policies for unsuccessful lessons learned, especially since there is no one correct or universal way to organize boards of directors. These same major board categories will be used in the next section to identify successful lessons learned from benchmarking in relation to Constellation Software's corporate governance policies. Constellation has been a very successful company.

- Board size: L Brands has 12 directors, comprised of a majority of independent directors (75%), as required by the U.S. stock exchanges, and similar to most large corporations having boards with 12 or more members per the Conference Board report.
- Board refreshment: L Brands has no formal board replacement policy but did replace two directors in the last two years due to retirements, consistent with the Conference Board report that director retirement seemed to be the only relevant refreshment factor.
- Board meetings frequency: L Brands meets five times a year with all directors attending 75% or more of the meetings. Per the Conference Board report, the majority of boards meet fewer than 8 times per year and average attendance percentages were not given.
- Board committees (compensation and nominating/governance): L Brands has three committees, composed of independent directors: compensation, audit and nomination/governance. Per the Conference Board report, only a small number of companies either combine or have no nominating/governance committee or have no compensation committee.
- Board committees (risk and audit): L Brands does not have a risk committee, a committee which is common in financial companies. L Brands' audit committee has risk oversight responsibility and met 13 times last year but none of its members have financial accounting backgrounds. It did not mention the emerging data privacy and cybersecurity challenges cited in the Conference Board report. S&P 500 audit committees are the busiest, meeting as many as 8 to 9 times per year with the median being 12 in the largest financial companies.
- Board committee rotation: L Brands does not mention reassessing annually whether the membership and leadership of its committees remain adequate, like most companies in the Conference Board report.
- Board leadership (duality model): The founder of L Brands in 1963 has always been the CEO and has had the duality model which combines the CEO and board chair positions for over 50 years until present. 53% of the S&P 500 companies use this duality model as do 39% of the Russell 3000 companies. Companies using the duality model typically cite the CEO's industry-specific experience and knowledge of the day-to-day firm operations while companies not using this duality model see opportunities resulting from having access to two different leaders.
- Board leadership (lead director): L Brands started the lead director position in 2012 and the same person has continuously held that position, acting as board chairman when the board meets without the chairman being present, similar to the Conference Board report where the appointment of a lead director has become a common practice.
- Board assessment: L Brands does not mention any periodic evaluation of the effectiveness of its board, individual board members, or individual committees. The Conference Board report found that 95% of the S&P 500 companies and 80% of the Russell 3000 companies conducted such annual performance assessments but in 80% of the Russell 3000 cases, the assessment is based upon self-evaluations.
- Board voting: L Brands has staggered (classified) board elections with only 3 of 12 (25%) directors being elected each year, like 60% of the smaller Russell 3000 companies and it has plurality voting to re-elect directors, like 52% of the Russell 3000 companies.
- Board tenure: The average tenure of L Brand directors is 20 years, versus the average tenure of Russell 3000 directors at 10 years. 25% of the Russell 3000 directors step down after more than 15 years of service.
- Board age: The average age of L Brand directors is 70 years old, like 20% of Russell 3000 board members who are more than 70 years of age.
- Board diversity: L Brands has 3 of 12 (25%) of its directors being female versus 20% of Russell 3000 boards with no female representatives.

Summarizing these board categories benchmarked by the Conference Board, L Brands has mixed comparative results. It has similar board policies on board size, board committees, board meetings frequency, board committee rotation, lead director, and board diversity. However, it has no policies on board refreshment or board assessment and weaker policies on board voting, board tenure, and board age. Especially troubling was L Brands' lack of a risk management committee since it is in the highly competitive and rapidly changing women's fashion industry. However, it did mention

such a task for its audit committee. L Brands has the CEO/board chair duality issue for over 50 years versus over half of European public companies and one-third of U.S. public companies having separated these two positions. Also, neither L Brands or the Conference Board report had specific recommendations for the split between short and long-term compensation for top executives. Another positive aspect of such benchmarking is to identify what board procedures are missing. L Brands has developed a succession plan, but such plans are not mentioned in the Conference Board report nor is a quota for female directors, as opposed to many European countries which now require a minimum number of female directors.

- The 2019 Barington Capital Group letter to the L Brand CEO, Leslie Wexner, recommended that his dual roles as CEO and chairman of the board (COB) should be held by separate individuals to improve corporate governance and operating execution. For example, ISS and Glass Lewis, proxy advisers, are pushing Boeing to separate the CEO and COB roles after the two fatal crashes of its 737 Max airplanes. They argued that the separation of these roles could eliminate the conflict of interest that inevitably occurs when a CEO is responsible for self-oversight (Thomas, 2019). The Barington letter to the L Brands CEO does not politely mention that he has been the only CEO since he founded L Brands in 1963, or 56 years ago. He has had the dual positions of CEO and COB for over 50 years and is now 80 years old.
- Barington also had significant concerns about the L Brands board being weak, observing that the board lacked the composition and independence necessary to perform its oversight functions on behalf of shareholders. Barington also stated that the board lacked directors with a diversity of backgrounds, skills, and perspectives enough to meet the strategic needs of the company and ensure that it remains competitive in today's challenging marketplace. Although L Brands had self-determined that eight of its 12 directors were independent per the New York Stock Exchange limited standards, Barington found a majority of these directors had strong ties to the CEO Wexner, his wife, who is also a board member, and to each other through the community in Columbus, Ohio where the company has always been headquartered, as well as The Ohio State University in Columbus, which is home to the Wexner Center for the Arts and the Wexner Medical Center. Barington commented that the existence of these business and social relationships raised serious questions as to the true independence of these directors. Furthermore, three of these so-called "independent" directors have a lengthy average tenure of 36 years, which raises concerns about their actual independence.
- Barington also said that the diversity of the L Brands board needed meaningful improvement. Even though the company's products cater primarily to women, nine of the twelve board members were men. The board also had limited age diversity with the average age of the directors being 70 and the median being 71, which is a concern as the company is currently having zeitgeist (characteristics of an age or generation) challenges connecting with younger customers for its women's fashion business. Furthermore, the board lacked directors with a recent operating background in fashion branded products that cater to women. As a result, Barington believed that a more diverse board in terms of age, gender, and professional experience would be more effective in providing advice to the management team and ensuring that important strategic and operating decisions are soundly made.

In summary, Barington recommended that the board should consider replacing the CEO's business advisor, the CEO's wife, and all directors with a tenure greater than 30 years and recruit new directors from outside of the Columbus, Ohio community. Such new board directors would help improve gender and age diversity on the board and add valuable experience in fashion retail merchandising, marketing, and international business development. As a frequent investor in retail and apparel companies, Barington offered to recommend several highly qualified individuals who would help improve the composition and diversity of the L Brands board. Finally, to improve corporate governance and operating execution, Barington recommended that the company should promptly declassify its board of directors in order to have annual re-elections of its entire 12-person board and separate the CEO and COB roles (Grove & Clouse, 2019).

5. BENCHMARKING BOARD OF DIRECTORS: STRONG LONG-TERM MARKET PERFORMANCE EXAMPLE

Constellation Software Inc., a Canadian company, acquires, manages, and builds vertical market software businesses. In the last five years, it has achieved significant increases in its stock price and market capitalization. Constellation's stock price increased from $345 to $1,310 (a 380% increase) and its total market capitalization increased by $21.5 billion to reach its current market capitalization of $29 billion at the end of 2019. Constellation Software has been the top-performing stock on the Toronto Stock Exchange over the last eight years with a 25-fold gain (Marotta, 2018). Over the last twelve years, Constellation's share price appreciated more than 50-fold, and the number of employees grew 12-fold (Leonard, 2018b). Accordingly, institutional investors have been very pleased with Constellation's market performance.

Based on this very successful company performance, the Conference Board benchmarking results by its major categories will be used to compare with Constellation's board of directors for successful lessons learned, especially since there is no one correct or universal way to organize boards of directors. The major board categories are as follows with corresponding benchmarking in relation to Constellation's corporate governance policies.

- Board size: Constellation has ten directors, comprised of a majority of independent directors (60%), as required by the Toronto Stock Exchange. However, most large corporations have boards with 12 or more members per the Conference Board report.
- Board refreshment: Constellation has no formal board replacement policy but did replace two directors in the last two years due to retirements,

like the Conference Board report that director retirement seemed to be the only relevant refreshment factor.

- Board meetings frequency: Constellation meets at least five times a year, once after each quarter, and once when the drafts of the annual report information have been prepared. Per the Conference Board report, most boards meet fewer than 8 times per year.
- Board committees (compensation and nominating/governance): Constellation has only two committees, composed of independent directors: a combined compensation, nomination, and human resource committee and an audit committee. Per the Conference Board report, only a small number of companies either combine compensation and nominating/governance committees or have no nominating/governance committee or have no compensation committees.
- Board committees (risk and audit): Constellation does not have a risk committee, a committee which is common in financial companies. Constellation's audit committee meets at least four times a year and all its members have financial accounting backgrounds. However, it did not mention the following new challenges in the Conference Board report. Audit committees continue to be the busiest, as their role needs to adapt to new challenges prompted by data privacy, cybersecurity, and financial risk oversight.
- Board committee rotation: Constellation reassesses annually whether the membership and leadership of its committees remain adequate which is like the Conference Board report.
- Board leadership (duality model): Constellation has always had a duality model with only two such individuals since its founding in 1995, like larger companies continuing to combine CEO and board chair positions. However, new economy business sectors, such as information technology and communication services, are more open to nonexecutive board leadership. 53% of S&P 500 companies continue to use this duality model of board leadership and 39% of the Russell 3000 companies combine these positions of CEO and board chair. Like Constellation Software Inc., 36% of information technology companies use this duality model. Companies using the duality model typically cite the CEO's industry-specific experience and knowledge of the day-to-day firm operations while companies not using this duality model see opportunities resulting from having access to two key leaders.
- Board leadership (lead director): Constellation chooses a lead director each year to act as board chairman when the board meets without the chairman being present, like the Conference Board report where the appointment of a lead director has become a common practice for corporate boards.
- Board assessment: Constellation periodically evaluates the effectiveness of its board but not individual committees or individual board members. The Conference Board report found that 95% of the S&P 500 companies and 80% of the Russell 3000 companies conducted such annual performance assessments but in 80% of the Russell 3000 cases, the assessment is based upon self-evaluations.
- Board voting: Constellation has not staggered (classified) board elections versus 60% of the smaller Russell 3000 companies. Also, Constellation has no plurality voting to re-elect directors versus 52% of the Russell 3000 companies.
- Board tenure: The average tenure of Constellation directors is 12 years versus the average tenure of Russell 3000 directors at 10 years. 25% of the Russell 3000 directors stepped down after more than 15 years of service.
- Board age: The average age of Constellation directors is 57 years old, versus 20% of Russell 3000 board members who are more than 70 years of age.
- Board diversity: Constellation has only 1 of 10 (10%) of its directors being female, somewhat like 20% of Russell 3000 companies' boards with no female representatives.

Summarizing these board issues benchmarked by Conference Board, Constellation has mixed comparative results. It has similar board policies on board size, board refreshment, board meetings frequency, board committee rotation, lead director, board assessment, board tenure, and board diversity. In contrast, it has better policies on board voting and board age. However, it has only two board committees, one combined compensation/nominating/human resource committee and an audit committee whereas most of the benchmarked companies have three or more board committees. Especially troubling was Constellation's lack of a risk management committee or even mentioning such a task for its audit committee, especially since it is in the highly competitive and rapidly changing and challenging software technology industry. Constellation also has the CEO/board chair duality issue which has caused over half of European public companies and one-third of U.S. public companies to separate these two positions. Also, neither Constellation or the Conference Board report had specific recommendations for the split between short and long-term compensation for top executives. Another positive aspect of such benchmarking is to identify what board procedures are missing. Constellation has an annual review to ensure that appropriate succession plans are in place, but such reviews are not mentioned in the Conference Board report. As opposed to the Conference Board report not mentioning such a quota, many European countries now require a minimum number of female directors.

Many of these board issues, identified by benchmarking, have been addressed by Mark Leonard, Constellation Software founder, CEO, and board chairman. In his 2018 Letter to Shareholders, he focused on the role that boards play in the success of a company (Leonard, 2018a). He argued that a board's real mission is to build long-term value and said it usually takes several years for a new board member to learn enough about a company to add real value as a director. He has a model for adding long term value by creating a culture of ownership through senior managers and directors holding substantial equity in this publicly listed Canadian company. Long-term oriented Incentive programs reward profitability and growth, whereby both senior managers and directors must be invested substantially in Constellation common stock which is held in escrow for an average of four years to develop a culture of ownership.

Leonard reflected on the difficulty of recruiting outstanding directors able to go beyond the expectations of conventional corporate governance to add long term value. For non-management directors, developing that valuable ability requires years of service, warranting long director tenues, in contrast to emerging corporate governance guidance which advocates term limits for directors. He commented that qualified and competent directors are very rare, and not surprisingly, the track record of most boards is simply awful. Leonard cited a study by Bessembinder (2018), showing that since 1926, only 4% of about 26,000 stocks in the Center for Research Security Prices (CRSP) database generated all of the stock market's returns in excess of one-month T-Bills during the last 90 years. Thus, only 4% of publicly listed company boards oversaw the long-term wealth creation by markets during that period while the collective boards of over 50% of these 26,000 same companies saw their businesses generate negative returns during their entire existence as public companies.

Leonard stated that improving various dimensions of corporate governance, such as diversity and independence, is necessary but not sufficient. Since such building of long-term value is the board's primary function, he said that it cannot be achieved by replacing proven directors of high-performance companies with new ones who are statistically very unlikely (see the 4% cited above) to have ever experienced consistent high performance. He argued that directors need to intently study an industry and company over a period of many years to acquire sufficient relevant expertise in order to contribute more than basic corporate governance, like firing a CEO who has been involved in fraudulent financial reporting. Leonard said his outside directors spend about 30 hours in board meetings each year and double that for preparation time. Engaged directors serving on committees, special projects, and extracurricular company activities could well provide up to 200 hours (or more) a year in person, and as much again in preparation, analysis, examination and review.

In summary, Leonard observed that most directors are simply too old to make the transition from a monitoring/governing role to a coaching/nurturing role in a high-performance company. Thus, the default role for most directors is being a relatively passive governor, not an engaged company mentor. Leonard concluded that if directors are not from the industry or the company, then they have no hope of coaching or mentoring unless they start in the director's job when they are young. He said that Constellation Software likes to get directors in their 40s or 50s and keep them for 30 to 40 years or until their health deteriorates, similar to the view of Warren Buffett, the chairman and CEO of Berkshire Hathaway, who said there is an increased value of contributions to be had with age. Buffett is 88 years old and his vice-chairman, Charlie Munger, is 94 years old. Leonard said that Constellation Software does not want to terminate its directors after they've served ten years, as many boards with director term limits do. He acknowledged that both Constellation's top-level company executives and its board do have a fundamental (compliance) corporate governance role but if this role is consuming most of their time, it is a sad reflection on their competence. His expectation is that both executives and directors spend much of their time in coaching/nurturing roles, bringing along managers and their teams, and making sure there is a strong bench of talent in order to develop long-term value (Grove & Lockhart, 2019).

6. CONCLUSION

The key question and major lessons learned in this research are that individual companies and their boards of directors should use the board director benchmarking information compiled in the Conference Board report to assess the corporate governance practices of their own boards of directors. A major way to do such benchmarking is to compare the financial performances of companies in both strong and poor stock market conditions. Benchmarking does not necessarily have to be with companies in the same industry in order to learn best practices. For example, this paper compared the poor long-term market performance company, L Brands, (Grove & Clouse, 2019) in the fashion wear industry with the strong long-term market performance company, Constellation Software, in the software industry (Grove & Lockhart, 2019).

From the results of those two studies, the major benchmarked differences in the boards of directors of these two companies were as follows:

- Specific industry knowledge: 7 of 10 (70%) of Constellation directors have software industry experience versus only 3 of 12 (25%) of L Brand directors.
- Younger directors: The average age of Constellation directors is 57 years old with average board tenure of 12 years while the average age of the L Brands directors is 70 years old with average board tenure of 20 years.
- Coaching/nurturing, involved roles: Constellation develops its board members to coach and nurture its managers and teams. Its directors spend at least 90 hours a year in board meetings and related preparation and some directors may spend 200 hours a year in such roles. L Brands makes no mention of these policies or hours beyond just 5 board meetings and an annual strategic retreat.
- Long-term compensation of directors: Constellation directors are substantially invested in Constellation common stock held in escrow for 4 years. L Brands makes no mention of such a director compensation policy.
- Board entrenchment: Constellation re-elects its 10 directors every year. L Brands only re-elects 3 of its 12 directors every year.
- Board assessment: Constellation periodically evaluates its board of directors. L Brands does not have such a policy.
- Board committee rotation: Constellation does an annual assessment of this item while L Brands only refers to this item.

These major differences in Constellation and L Brands boards can be benchmarked by other companies in helping to explain the differences in strong versus poor long-term market performances. Such benchmarking could help other companies

improve their corporate governance practices, their boards of directors and, hopefully, their long-term stock market and financial performances.

Other benchmarked board categories did not help explain the differences in Constellation's strong long-term market performance versus L Brands' poor performance as follows:

- Board size: Both companies were similar with Constellation having 10 board members and L Brands having 12.
- Board refreshment: Both companies added two new directors in the last two years.
- Board meetings frequency: Both companies' boards met 5 times a year.
- Board committees: Constellation has only two board committees while L Brands has three board committees.
- Board leadership (duality model): Both companies have this duality model.
- Board leadership (lead director): Both companies have a lead director.
- Board independence: Constellation has 6 of 10 (60%) independent directors. L Brands has 9 of 12 (75%) independent directors.
- Board diversity: Constellation has only one female director. L Brands has three female directors.
- Board age limits: Neither company has age limits for its board directors.
- Board term limits: Neither company has term limits for its board directors.
- Dual class voting shares: Neither company has dual class voting shares.
- Risk management committee: Neither company has such a committee.

Although advocated by many to improve the performance of boards of directors and corporate governance practices, the current popular topics of duality separation, diversity, age limits, term limits, and risk management committees, especially for cybersecurity, were not relevant in the comparison of the market performances of these two companies. However, all these other benchmarked board categories may be used by companies to see if they help explain differences in their comparative market performances. Thus, a major limitation of this paper, which could be investigated in future research, is to analyze benchmarked board categories to see if they help explain differences in comparative long-term market performances by many companies in key industries, like technology and health care since companies, their boards, their corporate governance, and their markets are diverse (Adams, 2017; Yermack, 1996). Also, the reverse phenomenon could be investigated: that firm financial performance affects corporate governance practices (Hermalin & Weisbach, 1998), especially in these times of the coronavirus pandemic.

7. FUTURE RESEARCH: 2019 TOP 10 CORPORATE GOVERNANCE TOPICS

For additional future research in benchmarking projects, the following top ten corporate governance topics predicted for 2019 by International Shareholder Services (ISS) could be investigated. ISS is the U.S.'s leading proxy advisory firm with over 61 percent of the business. It is the most powerful voice in advising investors to vote up or down each year on pay-for-performance plans, as well as board candidates and other initiatives that require shareholder approval. Its clients are hedge funds, mutual, funds, and similar organizations that own shares of multiple companies and they pay ISS to advise and often vote their shares regarding all shareholder votes ("Institutional shareholder services", 2019).

Its 2019 annual Analytics Report represented an independent, thoughtful analysis of the latest trends in corporate governance and shareholder voting (Papadopoulos, 2019). Investors, executives, and board directors should take a moment to reflect on key corporate governance priorities considering a potentially more challenging business environment in the years ahead. Many corporate governance topics that have dominated in the past few years, such as diversity, climate change, and cybersecurity, will continue to gain momentum and further prominence, as well as emerging corporate governance topics. ISS's list of ten corporate governance topics to watch in 2019 are as follows:

1. Diversity: Beyond gender and beyond the boardroom. Board gender diversity continues to be an item globally and ISS expects another record year for new female directors in many markets and a focus on the composition of senior management.
2. Climate change: New expectations on greenhouse gas (GHG) reduction targets and risk management. As the Paris agreement is set in motion, regulatory and industry-based initiatives are changing expectations about company behavior with respect to GHG or carbon emissions, energy efficiency, and environmental protection. For example, the voluntary Oil and Gas Climate Initiative (OGCI) was founded in 2014 by ten of the largest global oil companies after the Davos World Economic Council meeting in January 2014. OGCI is a voluntary CEO-led initiative taking practical actions on climate change and its now thirteen members leverage their collective strength to lower carbon footprints of energy, industry, and value chain transportation via engagements, policies, investment, and deployment (Grove & Clouse, 2019).
3. Market uncertainty and audit quality. In 2018, several major accounting scandals broke out across the globe, where several well-established firms either collapsed or were struggling to recover after revelations of poor accounting practices and audit failure. For example, Steinhoff International Holdings became South Africa's largest accounting scandal in 2018 and was nicknamed "South Africa's Enron" (Grove, Clouse, & Malan, 2019). Also, Glass Lewis, a proxy advisory firm, recommended that the head of Boeing's audit committee be removed, saying that the 737 Max plane crashes indicated a potential lapse in the board's oversight of risk management (Thomas, 2019). Companies with robust governance practices are expected to be better positioned to face a market downturn and other risks.
4. Executive misconduct and key-person risk. In 2018, prominent CEOs at Renault-Nissan-Mitsubishi, Wynn Resorts, WPP plc, and CBS, departed following misconduct allegations. Such examples have raised concerns over how boards can provide sufficient oversight over CEO behavior, especially when the CEO maintains control through economic ownership or dual class shares, like Facebook and Alphabet.

CEO duality is a related issue where the CEO is also the Chairman of the Board (COB). For example, Elon Musk, the Tesla CEO, was forced to give up his COB role after a settlement with the SEC over charges of stock manipulation. ISS and Glass Lewis were both pushing Boeing to separate the CEO and COB roles after the two fatal crashes of its 737 Max planes. They argue that the separation of these roles eliminates the conflict of interest that inevitably occurs when a CEO is responsible for self-oversight (Thomas, 2019). Activist investors are also pushing for such a separation of the CEO and COB positions (Grove & Clouse 2019). Five of the nine major oil companies in this study have this CEO duality problem: ExxonMobil, Total S.A., Noble Energy, ChevronTexaco, and Anadarko Petroleum.

5. Executive compensation: Pay in volatile markets — and fewer guardrails? 2018 was the first year of negative returns for the S&P 500 since 2008. Will the prevalence of relative total shareholder return ensure CEO pay increases despite a market downturn and have companies installed safeguards to limit requisite payouts in down years? Will the use of stock-based awards result in higher dilution rates as companies attempt to offset falling stock prices with the issuance of more shares or by using stock buybacks with the additional cash from the Tax Cuts and Jobs Act of 2017? Investors and board compensation committees should be paying close attention to trends in executive compensation.

6. The #MeToo movement: Equality in the workplace. In addition to sexual harassment, this movement touches on a host of issues pertaining to equality in the workplace, including the gender pay gap, workplace discrimination, and gender diversity. Emphasis on accountability at the highest levels of the organization, employee training, and governance mechanisms to prevent inappropriate behavior should play a significant role in addressing such issues and risks. Coming after the Millennial generation, the Gen Z generation expects businesses, brands, and retailers to be loyal to them. If they don't feel appreciated, they're going to move on. It's not about them being loyal to the business. Diversity is an expectation. Gen Z wants corporations to take a stand on issues, with over 40 percent saying they would pay more for a product if they knew the company was promoting gender equality issues or racial justice initiatives (Giammona, Wilson, & Ponczek, 2019).

7. Data security and data privacy. Cybersecurity and data privacy will remain key concerns in most industries. Typically, governance weaknesses are discovered after the fact, so most investors will likely pay close attention to crisis response and oversight by boards and management. The establishment of security risk management committees, the implementation of comprehensive security and privacy programs, and the presence of directors with expertise in cybersecurity and technology may serve as preventive measures. Also, the use of well-established cybersecurity description and control criteria will strengthen corporate governance (Grove, Clouse, & Schaffner, 2019).

8. Big Tech in the spotlight. Technology companies are likely to face increased scrutiny given their size and pervasiveness in the economy and society. From a pure corporate governance standpoint, concerns for board independence, board leadership, and dual class share structures will continue to receive significant attention, especially with the issues of election interference and fake news. Given their immense scale with an expansive user and consumer bases, any Big Tech firm activity may be subject to examination.

9. Current social issues: Gun violence and opioids. In 2018, investor concerns over the U.S. public health crisis, associated with gun violence and the opioid epidemic, appeared on many proxy ballots. Both campaigns proved very successful in either changing companies' behavior or receiving majority support. ISS expects these campaigns to continue with further impetus given the level of responsiveness from companies and investors, as well as the Gen Z expectations for companies to take stands on issues (Giammona et al., 2019).

10.Politics, protectionism, and cross-border transactions. With the race already on for the U.S. presidential election, investors should expect to see a large number of shareholder proposals seeking disclosures on companies' political spending and other political activities, especially with the anti-globalization rhetoric of populism. In the U.S., the President issued a 2018 executive order, blocking the Qualcomm-Broadcom merger transaction on the grounds of national security considerations. In Europe, Belgium and the Netherlands are raising protectionist measures against cross-border shareholder activism.

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