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A Pioneer of Corporate Governance Retires

Featuring:

Ric Marshall, *ESG Researcher, MSCI*

Mike Disabato:
What's up, everyone, and welcome to the weekly edition of ESG Now, where we cover how the environment, our society and corporate governance affects and are affected by our economy. I'm your host, Mike Disabato, and this week we have a special episode for you, featuring Ric Marshall, one of the most influential researchers on corporate governance to date. He's also my colleague who is retiring this month. Thanks as always for joining us. Stay tuned.

Mike Disabato:
We have a special episode for you today because my colleague, Ric Marshall is retiring this week. He is one of the fathers of corporate governance, starting one of the first governance ratings data sets at a long ago acquired company. Understanding corporate governance, how a board manages its company and ensures shareholders are not ignored was a precursor to the ESG acronym. After ESG was coined by the United Nations Secretary-General, Kofi Annan in 2004, the G has always been the more astute member that allowed ESG to gain ground in more conservative financial circles that were less concerned with how the environment and social issues like labor management affected a company. So in a way, governance was the father of ESG, helping it arrive where it is today. But I was curious how Ric decided to get into this space when it was a little known industry niche in the '70s. He told me that it was all because of a mix up at a food co-op.

Ric Marshall:
That was kind of a funny story really. I was in college at the time and looking for a job. I answered an ad in the paper. I went down and was interviewed by the entire board of a whole foods co-op. It was super interesting group. I was really excited to get the job. I thought, geez, I'm going to be working with these really interesting people. There were several professors from the local college, there was a Quaker background in the group, and we were to use the idea of consensus decision making. I mean, all these new concepts that sounded really great to me. I show up and I meet my co-manager, and we're given this huge desk, a partner's desk and we're sitting facing each other. Everything was super egalitarian. This is late '70s, so still in those post '60s era philosophy. I started the job and learned how to open the store and close the store and stock things and work with members and what the basic ideas, and the entire board, sans one resigned. And I, "Okay, what?"

Mike Disabato:
Ric, his co-manager and one board member were left alone at a co-op serving hundreds of people in North Carolina. To be honest, I think I would've bailed, but they decided to stay and got to work rebuilding the board, piece by piece and kept the whole co-op afloat. It's actually even running to this day. But it was because of the stark and memorable interaction with the lousy board early on that Ric dedicated his life to understanding

board's influence over corporations. That soon led him to team up with some of the most influential people in corporate governance, Bob Monks and Nell Minow, who actually wrote the book on Corporate Governance, the fifth edition of which was recently published. It's just called Corporate Governance, of course.

Ric Marshall:
Fast forward to the mid '90s, and I found myself working with Bob Monks and Nell Minow, who had together originated ISS in the mid '80s.

Mike Disabato:
ISS, or the institutional shareholder services became known for their advice to shareholders on how they should vote on their proxy statements. ISS has more or less become the industry standard because they helped shape around 12 million ballots at 40,000 shareholder meetings and counting. They are like the IMDB of proxy voting. So Ric began to work with those that started this voting service in the beginning. Eventually after some years, Monks and Minow decided it was time to make a change.

Ric Marshall:
In just a very, very short period of time, we reached a place where they wanted to move on to their next adventure, which turned out to be the idea of rating companies on corporate governance. So that's what they did, and they invited me to be an equity partner. In fact, I was the original CEO of that adventure, which was called The Corporate Library. We started working on a rating scheme for US, mainly US companies' corporate governance, and that's where it really all began for me and got serious.

Mike Disabato:
This was one of the first rating systems ever made. Everything you are hearing now about ESG from all the lauding it's getting to the criticism that has found its way to even The Economist a couple weeks ago, this wouldn't have been possible in part without Bob Monks, Nell Minow and our very own Ric Marshall creating a ratings database by hand in the '90s. What Ric and his teammates were trying to understand was where the companies in the US were most equitable, which could be most influenced by an activist shareholder that wanted a company to go in another direction than it currently was.

Ric Marshall:
One of my contributions early on was the recognition coming out of the activist period that if a company had a controlling shareholder, minority investors didn't have much leverage. We would never pick a controlled company as a focus company or a target company for an activist campaign, unless there were very specific conditions involved. So ownership became a critical part of our thinking when we looked at corporate governance, separating out what's a controlled company from what's a widely held company.

Mike Disabato:
Ric and his team continued to work in semi-ambiguity, doing what relatively unknown but forward thinking companies do, cold calling people and trying to get into rooms to make them understand the importance of corporate governance. Then in late 2001, about three years before the creation of ESG, the world was rocked

by a shattering disillusion.

Speaker 3:
The House Financial Services Committee will begin the first Congressional hearings on the Enron debacle tomorrow morning, but they'll be doing it without much help from Enron. Late today the company announced that neither CEO Ken Lay or any other company representative will be here to answer questions.

Mike Disabato:
That was a clip from NBC News 2 Houston, talking about the largest bankruptcy in American history, Enron that put corporate governance on everyone's mind.

Ric Marshall:
Enron changed everything. We went from cold calling everybody in New York to having a lot of people in New York calling us and saying, "We understand you are rating companies on corporate governance. Will you come down and tell us about it?" It made the business into something viable. People started thinking about corporate governance as a more important thing than they previously had. Clearly this was a governance failure. The board had failed to protect the interest of investors, indeed, the interest of all stakeholders around that company, customers, the employees, employees lost their pensions, and it all came down to mistakes that management made but the board enabled. That's the worst case scenario in corporate governance. We want the board to be looking over the shoulder of management and making sure that those kinds of mistakes are not being made and that those kinds of risks are not being taken.

Mike Disabato:
But this failure didn't mean that company boards were open to speaking with investors, even if investors were more interested in speaking with them. Compared to today, where companies have a robust channel of communication with investors via their investor relation teams often, Ric was talking about the importance of understanding corporate governance as almost from afar for investors.

Ric Marshall:
In those days, the idea that the board of directors represents the interest of the investors was purely abstract. There really was very little reality behind it. I mean, yes, companies had annual meetings and yes, investors got to vote and yes, a few investors would come to the meeting and stand up and ask for something or say something. There were even a few shareholder proposals being filed. But by and large, companies did what they wanted to do, at least in the United States.

Mike Disabato:
But inroads were being made. ISS, the company I mentioned earlier that helps in part advise investors on how they can vote their proxies had coalesced investors sentiment into a force that companies had to start paying attention to because ISS was scrutinizing and informing investors on what was on the agenda at their company's annual general meetings. But even as that was happening, everything stayed more or less static until another even bigger economic calamity hit in the form of the mortgage crisis of 2008, which then led to the passage of the Dodd-Frank Act. Part of the Dodd-Frank Act highlighted the pay gaps between CEOs and their workers, and it created what's called the say-on-pay law that asks investors to vote in their proxies on the compensation of the top executives of the company and what they thought about that compensation. This

opened the door of communication between directors and investors in a recurring and persistent way, and this type of communication became something that companies had to pay attention to.

Ric Marshall:
Well, after Dodd-Frank and the implementation of say-on-pay, I've certainly seen a big increase in communication between investors and boards. Say-on-pay requires that every company submit their pay plans for their top executives for shareholder approval. That's just an open door to an issue that's going to be voted on and requires boards to reach out more specifically about corporate governance practices to their investors. I think what we've seen is a gradual movement away from the old adversarial only approach to talking with investors. We're actually starting to see real engagement. At the same time that companies have begun to change, investors have begun to change, and investors have begun to realize the importance of engagement, of talking with boards. By engagement, I don't just mean shareholder proposals. Shareholder proposals are a worst case scenario tool, when normal engagement, when talking and having discussions fails.

Ric Marshall:
When you see a shareholder proposal at a company, it means that the company is in some, on some level is being resistant to talking with investors about those issues, and the investors have lost patience, and quit trying to have a discussion and be collaborative, and are asking other investors to weigh in and vote in favor of their views. But that's the tip of the iceberg. The vast majority of engagements these days take place in a very, a much more collaborative kind of way. As I say, a lot of that was opened up by say-on-pay. Ironically, I'm not sure that the say-on-pay part has made much of an impact on CEO pay or other executive pay itself, but it has opened the channel of communication in a different way for investors. And that's been huge.

Mike Disabato:
Yeah. Investors got to have a say on what the company they gave capital to is doing, kind of. Engagement is one of those cornerstones of ESG. It is what many ESG fund managers point to as their differentiating aspect. They say things like, "We work with companies to ensure they are pursuing the most sustainable future through engagement." Say-on-pay created the bridge that allowed engagement to become a more effective tool at the hands of investors. This possible collaboration that can happen now between investor and company is actually one aspect Ric wanted to see develop further, after he steps back from professional life, for companies to better listen to their shareholders and to adapt to the changing times.

Ric Marshall:
If I had any message for those directors, it would be mainly to focus on the relationship that they have with their investors. That is to say the old way of being adversarial, of being resistant to communication, of being resistant to ideas from investors, that doesn't work. What works is collaboration. Investors are providing capital for your firm. Many investors are very sophisticated. They own positions in many different companies. They have enormous exposure to capital markets, and in many cases, years of experience in working with companies, and deciding which companies to invest in, and analyzing the way the market works and the different issues of importance that drive the market, including ESG issues.

Ric Marshall:
If boards, if directors and boards would be more open to collaborating with their investors and discussing the ideas that their investors have, I think that would be true leadership and we'd all benefit from that. Companies would not only perform better in the market and be perceived more positively, but I think we would be able to solve some of the problems that we are constantly looking at in ESG, like climate change, much more quickly

and much more easily. It's the resistance to change and the resistance to the idea that investors have something to contribute that is at the heart of some of the worst disasters in corporate governance history. It doesn't need to be that way.

Mike Disabato:
To end, I have to say corporate governance usually doesn't get the greatest rap. It's wonky. It's mind-numbing at times. The most enjoyable representation of it is actually the hit TV show, Succession, which I highly suggest if you haven't seen yet. But most people often turn toward the E or the S in ESG. So I wanted to end this with Ric telling me why he decided to pursue governance throughout his professional tenure.

Ric Marshall:
Well, the other thing that it's important to recognize about corporate governance is that it's not about the structures and it's not about best practices. We spend way too much time talking about those things, arguing about those things. Should it be this, should it be that, should a board be classified? Those questions are not unimportant, but ultimately corporate governance is about people. It's about people and it's about leadership. For me, that's really the key to making it work. As a person who's not on a board, not running the company but actually looking at companies, looking at their corporate governance and rating them, I always in the back of my mind somewhere trying to remember that this is about people, and that will always be the bottom line when you look at a board. It's not, is it a classified board? Is there a separation between the CEO, chair? Those are questions you can ask forever. It really comes down to, is this board doing what's needed to make this the most successful company in that broader sense of making the world a better place?

Mike Disabato:
That's it for the week. I wanted to thank Ric Marshall, not just for discussing the news with an ESG twist with me this week, but for everything. Ric, I'm going to miss you terribly. I can't say it enough. I don't know what I'm going to do without you at MSCI. I hope your retirement is as fruitful as your professional career was. Thank you all for listening. I hope you like what you heard. If you liked it, don't forget to rate and review us. That really helps. And subscribe wherever you get your podcasts. Thanks again, and talk to you next week.

Speaker 4:
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