How Well Do You Really Know the Shareholders You Represent?

By David Shaw

A few years back, I was at a non-business cocktail party, chatting with someone I had just met. It was a great conversation, as I recall, until I learned that he was a board member of a company in which I held stock, and I shared that fact with him.

My holdings were small, comparatively, but large enough to be very relevant to me. This may have been a wonderful opportunity for this board member to ask some questions of me, get my opinions — you know, get to know one of the owners. The other parts of our conversation had been vigorous and interesting.

You can guess what happened, of course. The conversation died out quickly, and drinks needed refilling. And we didn't speak again that night, or any other time.

Fully understanding the desires and goals of shareholders is a key to good company governance, and in this regard directors at publicly traded companies can take a lesson or two from their private company counterparts, especially when it comes to the growing conversations around environmental, social and governance (ESG) issues.

At our most recent Private Company Governance Summit, held in June in Washington, D.C., I was struck by several discussions and comments that made me reflect on whether ESG and shareholder primacy are necessarily exclusive and contradictory ideas.

During a conference session on shareholder relations, it was pointed out that in a typical well-governed private company, with a board composed of a majority of independent directors, the odds are very high that board members know every shareholder/owner personally, and that a major shareholder or two serves on the board. Even if there are too many shareholders to know individually, there is often a mechanism to allow clear ownership communication with the board

through an owner's council or other shareholder representatives.

While private company shareholders often want and need regular dividend distributions, the overall goal of many private companies is often their own perpetuation, usually to a new generation of owners. That kind of thinking often leads to short-term sacrifices in return for long-term gain. (I, of course, exclude many private equity, venture capital and other pre-IPO types of private companies here.)

At the summit, we also held a group workshop on the board's role in ESG and sustainability for the private company, led by senior partners of Deloitte. It made clear that private companies, especially those that are family- or employee-owned, have long been at the forefront of many ESG issues, including their company's responsibilities to their employees, communities and customers. As one attendee put it, "it seems that sustainability and ESG are the new buzzwords for things we've always done."

I think the two concepts of knowing your shareholders' goals directly and intimately, and having a firm concept of the company's responsibilities to its various stakeholders, are related for many private companies and their boards.

How well do public company boards know what their shareholders really want? The Delaware courts have interpreted the Duty of Loyalty to mean that directors must act in the interests of shareholders, but those interests are often interpreted to mean a focus on short-term gain and return on investment. But is that always the case?

While the last few years have seen an increase in calls for board members to be more available to shareholders, I'm sure you know more than a few directors — as I do — who don't want anything to do with direct communication with shareholders. Granted, such communications can be fraught with opportunities for potential regulatory violations — think the SEC's "Regulation Fair Disclosure" rule that tries to curtail selective disclosures to investors, for example. But a lot of the liability comes from what a board member might disclose to a shareholder. It doesn't prevent the board member from listening to and getting to know the shareholder.

There are so many layers between public company board members and their average shareholder — the investor relations team, the institutional investors who represent thousands or millions of small shareholders, proxy votes and stock analysts. Adding to the difficulties are poorly attended annual meetings.

But ask yourself this: Do you really know what your shareholders want? Certain institutional investors are making clear what they expect from the companies in which they invest the life savings of their own investors. But does this really represent all, or a preponderance, of your shareholders' goals and desires? If you're not sure of the answer to this, can you really judge if and how ESG fits the company you serve?

The Duty of Loyalty shouldn't be to a hypothetical shareholder, of course, but to actual real live owners of the company, even those you meet at random cocktail parties.