A Voice in the Boardroom

EXECUTIVE SUMMARY

Practical guidance for voting proxies to influence corporate governance, sustainability, and performance

Please see important disclosures at the end of this report
Authors

John K.S. Wilson is the Head of Corporate Governance, Engagement & Research at Cornerstone Capital Group. He leads a multidisciplinary team that publishes investment research integrating Environmental, Social and Governance (ESG) issues into thematic equity research. He also writes and presents widely about the relevance of corporate governance and sustainability to investment performance for academic, foundations, corporate and investor audiences.

John has nearly two decades of experience in sustainable investing and corporate governance. Previously, he was Director of Corporate Governance for TIAA-CREF, the largest private pension system in the United States with assets under management of over $500 billion. In this role, he oversaw the voting of proxies at 8,000 portfolio companies and engaged in dialogue with corporate boards and management to develop and promote best practices for corporate governance and sustainability. Earlier, he was Director of Socially Responsible Investing for Christian Brothers Investment Services, an investment advisor to Catholic institutions, leading its shareholder advocacy, social screening, and proxy voting functions.

An Adjunct Assistant Professor at Columbia Business School, John is also a member of the Advisory Council to the Sustainability Accounting Standards Board. He is a past Vice-Chair of the Interfaith Center on Corporate Responsibility and was a founding advisory committee member of the International SRI Working Group, a think tank serving social investing professionals.

John holds an MBA and a Master of International Affairs degree from Columbia University and a BA in English from Georgetown University.

Caleb Ballou is a Research Associate at Cornerstone Capital Group. He recently completed a dual MBA and MA in international affairs at Columbia University.

Acknowledgements

We would like to thank the following individuals, all of whom are noted experts in the field of corporate governance and sustainable investing, for their kind advice and guidance on this report:

Laura Berry, Theresa Goody, Catherine Jackson, Karina Litvack, and Peter Reali

A Voice in the Boardroom (Executive Summary): Practical guidance for voting proxies to influence corporate governance, sustainability, and performance

Published July, 2016
INTRODUCTION

I. OVERVIEW: THE INVESTOR AS STEWARD OF CAPITAL

II. UNDERSTANDING THE PROXY VOTE

1. What is proxy voting?
2. Who votes?
3. For fiduciaries, what are the duties surrounding proxy voting?
4. What kinds of questions appear on proxy ballots?
5. How does proxy voting influence corporations?
6. How do institutional investors determine their voting policies?
7. What is corporate governance and why is it important?
8. What is shareholder engagement?
9. How do shareholder proposals contribute to shareholder engagement?
10. Is shareholder engagement the same as shareholder activism?
11. Does proxy voting matter?

III. DEVELOPING AND IMPLEMENTING A VOTING POLICY

1. Establish objectives
2. Assess available resources
3. Develop policy
4. Engage partners and execute policy
5. Monitor results
6. Communicate to stakeholders and assess progress

In more detail: In-house or outsource?

IV. GOVERNANCE THEMES

Boards of directors
Integrity of financial disclosures
Executive compensation
Sustainability
Voting rights, capital structure and corporate restructuring

V. GLOSSARY

VI. ADDITIONAL RESOURCES
INTRODUCTION

We have also learned, and firmly embrace the belief that strong, accountable corporate governance means the difference between long periods of failure in the depths of the performance cycle, and responding quickly to correct the corporate course.

- California State Public Employee Retirement Service (CalPERS)
  Global Governance Principles 3/14/16

This document is the executive summary of our proprietary guide to voting proxies. *A Voice in the Boardroom* is written for organizations and individuals who want to use their voice as shareholders to influence companies, but are not sure how to get started. It is meant primarily for asset owners — endowments, foundations, family offices, individuals or others — who are long-term stewards of capital on behalf of themselves and others.

Shareholders have the power to influence companies by engaging them in dialogue around social, environmental and governance concerns. We call these activities **active ownership**, the primary mechanism of corporate democracy. Active owners have helped bring about change in the policies of thousands of companies on such issues as climate change, board diversity and executive compensation, benefiting companies, investors and society as a whole. **Proxy voting** is a crucial tool in the engagement process.¹

For small-time owners of common stock, it can be easy to discount the importance of participating in proxy voting. But adding one’s voice to those of other shareholders, large and small, can garner attention and influence the board of directors, management, and the social and environmental policies of a company. Even a small shareholder’s voice can become part of a larger trend of advocacy.

Because of the complexity of modern corporations and the diversification of many investment portfolios, the idea of getting involved in active ownership may seem daunting. But the corporate governance novice is not alone. There are numerous partners available who possess the experience and expertise to support investors, whether they aspire to become thought leaders who actively engage companies or merely want to ensure that their institution’s shares are voted in a thoughtful manner.

To get the most out of these partnerships, investors must be able to have an informed discussion about proxy voting and corporate governance with internal **stakeholders** such as boards, donors and staffs, and external stakeholders such as proxy agents, asset managers, and custodial banks. By understanding how the proxy process works and what the issues are, investors can position themselves to carry out their priorities efficiently and effectively.

I. OVERVIEW: THE INVESTOR AS STEWARD OF CAPITAL

It may come as a surprise that the primary purpose of the public equity markets is not to finance new business investment. Public companies typically use internal cash flows rather than the capital markets to fund the investments in property, plant, equipment and other expenditures that enable their growth. In fact, public companies in the US and other markets buy back more equity shares than they issue in a given year. The function of funding new investments resides more in other asset classes such as venture capital.

Public equity investors do serve an important function, however: to serve as stewards of their existing investments. Stewardship involves a commitment to engage with companies, through both proxy voting and shareholder–company dialogue, to answer some of the most important questions about how companies govern themselves:

■ Can investors feel confident that the managers of public corporations, to whom they have entrusted their capital, will act in shareholders’ best interests?

■ Will corporate managers look to build enduring value, rather than pursue short-term profitability that places the institution at greater risk over the long term?

■ Will companies behave responsibly towards other corporate stakeholders such as employees, customers and society?

Why is stewardship necessary?

Investment in the public equity markets brings numerous advantages over investments in other asset classes or direct investments. Important among them is the ability to diversify a portfolio across companies and industries. Equity investment also requires a “separation of ownership from control”—the owners of capital delegate the job of running companies to professional boards and management teams. There are real benefits to delegating the day-to-day management of companies to specialists with specific industry expertise.

However, this separation creates risk in the form of the principal-agent problem. Managers are hired to deliver returns to shareholders, but may be tempted to make decisions that benefit themselves at the expense of the company. Or, they may choose a strategy that earns high returns immediately but places the organization at risk in the future. Or, surrounded by like-minded individuals, they may become victims of “group-think” and miss the early signals of social change that will impact their competitiveness.

Moreover, as large companies supply an increasing share of the global economy, a narrow focus on maximizing shareholder returns without regard to the welfare of other stakeholders can exacerbate social ills such as pollution, inequality, or public mistrust of society’s institutions. Ironically, over the long term, exclusive focus on short-term profit maximization can actually undermine the interests of the shareholders themselves—as the financial crisis of 2007-08 demonstrated.
The link between governance and sustainability

As owners of companies, shareholders are well positioned to play an important role in addressing these issues within their investment portfolios. Shareholders can't micromanage companies and shouldn't try. However, they can encourage rules of the game that hold corporate leaders accountable to shareholders, offer incentives for long-term, sustainable value creation, and encourage consideration of how corporate decisions affect society as a whole.

We call these rules of the game corporate governance, defined as the relationship among all corporate stakeholders that determines how decisions are made about the strategic direction of the firm. Corporate governance defines the roles and responsibilities of shareholders, management, and boards.

Sustainability is a core element of good corporate governance. Cornerstone Capital defines sustainability as "the relentless pursuit of material progress towards a more inclusive and regenerative economy." Companies become more sustainable by maintaining constructive relationships with stakeholders such as employees, suppliers, customers, and society as a whole. These relationships matter for corporate business performance because a company’s stakeholders are the ultimate source of its ability to create value.2

For this reason, although some stakeholders may not have a formal role in corporate decision-making, companies that fail to incorporate legitimate concerns of stakeholders into strategic and operational decisions do so at their own peril—as companies such as BP, Valeant Pharmaceuticals, Volkswagen and many others have learned.

While historically many investors saw proxy voting and engagement as a low priority, a growing number now view this oversight function as critical to the effective functioning of the capital markets. This guide is intended to help investors learn how to use the power of proxy voting and engagement to influence companies and bring about a more sustainable economy.

Corporate social responsibility is a hard-edged business decision. Not because it is a nice thing to do or because people are forcing us to do it... because it is good for our business.

- Niall Fitzgerald
Former CEO, Unilever

II. UNDERSTANDING THE PROXY VOTE

The executive summary offers a concise explanation of proxy voting basics. In our full-length report, we present the rationale for voting, a more detailed explanation of some of the major concepts related to corporate governance, and pragmatic guidance for getting started.

1. What is proxy voting?

Shareholders of companies have the right to vote on certain matters relating to governance and sustainability at annual or special meetings. Examples of voting matters include the election of directors, approval of executive compensation plans, or proposals filed by shareholders on social or environmental policies. Because most shareholders do not actually attend meetings in person, their votes are considered “by proxy.” The votes can influence the leadership, direction and strategy of the company.

2. Who votes?

Owners of common equity shares in companies are entitled to vote, generally in proportion to their ownership stakes. Many shareholders invest through intermediaries, such as mutual funds or pension funds. In cases where the intermediary is the legal owner of the shares, it is required to cast ballots in the best interest of the ultimate beneficiary. Many of these intermediaries publish information about their votes online, affording their beneficiaries the opportunity to review the voting records of those investing on their behalf.

3. For fiduciaries, what are the duties surrounding proxy voting?

Fiduciaries are obligated to act in the best interests of their clients. In the United States, Securities and Exchange Commission (SEC) rules include proxy voting as part of that obligation.

4. What kinds of questions appear on proxy ballots?

Proxy items may be routine governance items submitted by management, such as the election of directors or ratification of auditors, or they may be proposals submitted by shareholders that raise concerns about companies’ governance or sustainability practices such as diversity, climate change or human rights. Most management proposals are binding, while shareholder proposals are typically non-binding, or advisory, and instead are intended to promote dialogue on a topic. While many markets allow shareholder proposals, they are most commonly found in the US, where the law is most supportive.
5. How does proxy voting influence corporations?

Investors can signal concerns to companies either by voting against management proposals or by voting in favor of shareholder proposals. In unusual cases management is forced to take or avoid action because of a majority vote against its recommendation on a binding ballot item. In most cases, proxy votes add value by providing companies with information about shareholder sentiment. When faced with substantial opposition to its preferred policies, management may choose to engage with shareholders with the objective of addressing their reasonable concerns.

6. How do institutional investors determine their voting policies?

Most institutional investors, whether asset owners or asset managers, develop proxy voting policies, or a set of guidelines that determine how the institution will vote; many of these policies are available publicly. Fiduciaries must consider long-term shareholder value in voting clients’ or beneficiaries’ proxies. They may also consider the social or environmental impact of these decisions, but only if doing so does not compromise their fiduciary duty. An investor’s proxy voting policies define the approach the investor will take to balance these considerations and best serve beneficiaries. Some investors are more willing than others to challenge management and boards.

7. What is corporate governance and why is it important?

Corporate governance is the relationship among all stakeholders that determines how a company is controlled and directed. It defines the rights and responsibilities of various corporate stakeholders, especially shareholders, boards, and management. Corporate governance matters because it determines how companies make decisions and who benefits from those decisions. Sustainability—the relationship between a corporation and its stakeholders (e.g. customers, suppliers, employees, society at large) —is a key component of corporate governance.

Corporate governance

1. Accountability

2. Incentive alignment

3. Principled culture

Transparency & engagement
8. What is shareholder engagement?

Shareholder engagement is a strategy used to open channels of communication between a shareholder and a corporation, often with the goal of improving the company’s handling of environmental, social, and governance matters. Shareholders exercise their rights as owners of companies by actively engaging in dialogue with companies to support long-term value creation.

9. How do shareholder proposals contribute to shareholder engagement?

Shareholder proposals are the most visible aspect of shareholder engagement, but they are just the tip of the iceberg of the ongoing discussions between shareholders and companies. They are successful when they catalyze an in-depth, productive dialogue between companies and shareholders that results in a collaborative solution to shareholder concerns which also makes the company stronger over the long run.

10. Is shareholder engagement the same as shareholder activism?

Shareholder activism differs notably from shareholder engagement in that shareholder activism specifically implies an intent to modify a corporation’s strategy or the composition of its leadership without necessarily obtaining the prior consent of company management and/or the board of directors.

11. Does proxy voting matter?

As the owners of equity in companies, shareholders are exposed to both the opportunities and the risks arising from company decisions. Proxy voting is their voice in the boardroom. It ensures that their interests will be represented in board discussions, and is the most direct and legitimate means of raising social and environmental concerns directly with companies.

“...In the end, what matters most is not rules, but how people actually behave. And what is it that determines how employees behave? Behavior is driven by a company’s values and its culture. That’s why values and culture are the ultimate keystones of governance. They are what lead people to do the right thing, even when nobody is looking. For that reason, it’s just as important for a company to focus on the so-called “software” of governance — its culture, people, leadership and values — as it is to focus on the “hardware” — the structures and processes.

- Roger Ferguson
President and CEO, TIAA-CREF
Raytheon Lectureship in Business Ethics
April 2, 2013, Center for Business Ethics at Bentley University
Conscientious financial stewardship demands that proxy voting rights, like all other economic assets of the foundation, be managed with proper care and attention.

[Proxy voting guidelines] also help to advance one of the major objectives of the Fund’s grants program, namely to strengthen the democratic governance of key institutions. The foundation is dedicated to helping citizens become more engaged and empowered and to encouraging institutions of governance to become more inclusive, transparent, and responsive in order to increase their effectiveness. Voting rights give shareowners the opportunity – and the responsibility – to participate in the governance of publicly owned corporations. If shareowners engage actively with this responsibility, the structures of corporate governance will be strengthened and the prospects for favorable long-term financial performance will likely be enhanced.

- Rockefeller Brothers Fund

Proxy Voting Guidelines and Procedures

Beneficial owners of shares have a right, and in some cases a fiduciary duty, to vote shares in the best interests of the ultimate beneficiaries. Investors have numerous practical options for voting shares.

Proxy voting is most effective when it is conducted in a manner that is well-thought-out, efficient, and consistent. We suggest the six steps illustrated on the following page as a framework for developing an approach to proxy voting and engagement that is consistent with an organization’s mission, fiduciary duty, and best voting practice. These six steps are examined in more detail in the full-length report.
Proxy voting implementation: Steps to success

1. Establish objectives
   **Question:** How do we want to link our proxy voting to our mission and/or values?
   **Partners:** Boards & internal stakeholders; external advisor

2. Access resources
   **Question:** How will we ensure that our proxy policies will be carried out?
   **Partners:** Voting agent; asset manager; coalition partners; Internal governance team

3. Develop strategy
   **Question:** How will we address specific governance issues that come before us?
   **Partners:** External advisor; internal stakeholders; asset managers; voting agents

4. Engage partners
   **Question:** How will we ensure that our proxy policies will be carried out?
   **Partners:** Voting agent; asset manager; coalition partners; Internal governance team

5. Execute strategy and review progress
   **Question:** Are we demonstrating operational excellence? Did we meet our objectives?
   **Partners:** Voting agent; custodian/broker; internal governance team

6. Communicate with stakeholders
   **Question:** Are our stakeholders well-informed about our activities? Are they empowered to provide input?
   **Partners:** All stakeholders
While shareholders may be called on to vote on a large number of individual items, there are five governance themes that are critical for the governance of every firm. These are:

**Boards of Directors:** The board of directors is the body that directly oversees management and holds them accountable to shareholders.  

**Integrity of Financial Disclosures:** These mechanisms ensure that shareholders can trust the accuracy of the information that they receive from companies.  

**Executive Compensation:** The manner in which executives are compensated determines the incentives that drive management behavior and priorities.  

**Sustainability:** A company's sustainability policies and the quality of its relationships with its stakeholders provides insight into the management of risk and the company's capability to take advantage of opportunity in the long term.  

**Voting Rights, Capital Structure and Corporate Restructuring:** These technical matters help to maintain a proper balance of power in a company as well as ensure that strategic decisions are made with appropriate input from shareholders, boards and other stakeholders.

For those interested in learning about the basics of each theme, there is an introductory section called **What is this theme about?** Our full-length report explores each theme in more depth via the sections titled **What do I need to know?** and **What should I think about before voting?**
The board of directors is a group of people elected by shareholders to oversee the company’s strategy and operations. Directors may be corporate executives or non-executives — i.e., any directors not employed by the company. Directors do not manage the company day-to-day; this is the role of management. Board members are usually nominated by a committee of the board and elected by a vote of all shareholders. For most companies, directors do not serve full-time; the board and its committees meet several times per year, with certain board members responsible for some tasks conducted outside of regular meetings.

The board is obligated to act in the best long-term interests of the company, and to safeguard the interests of all shareholders equally. More specifically, the board fulfills the following responsibilities:

- **Oversee the development and implementation of firm governance and strategy:** Boards establish rules for the relationship among various stakeholders, particularly for strategic decision-making. Boards set the strategy of the firm and hold management accountable for the execution and results.

- **Supervise the Chief Executive Officer (CEO):** Boards hire and fire CEOs, set compensation for CEOs and other top executives, and establish incentives and expectations for these roles.

- **Ensure the financial integrity of the firm:** The board reviews the **internal controls** and financial disclosures to assure that they are accurate, complete, timely and transparent, and to manage conflicts of interest. The board also oversees the management of the firm’s capital structure, including such issues as leverage, dividend policy, and share issuances and buybacks.

- **Set the ethical tone for the organization:** Boards are responsible for modeling ethical standards, establishing a culture of compliance and **transparency**, and setting expectations for stakeholder engagement.

In some companies that are controlled by a majority shareholder or group of shareholders, the controlling shareholder may assume some functions normally fulfilled by the board, such as CEO selection. In these cases, investors may have more limited ability to influence the governance of the company.

In some non-US markets, shareholders cast a single vote on an entire slate of nominees rather than individual director candidates. This may create a dilemma for some shareholders because various provisions may seek to protect the interests of minority shareholders or constituencies other than shareholders. Therefore, the shareholder may face a choice of opposing an entire board or supporting some directors who are not fully aligned with their interests.

---

3. There are different ideas about to whom the board of directors owes its fiduciary responsibility, and in some non-US markets, boards may include representatives of other stakeholders, such as labor.
Integrity of financial disclosures

Trust is indispensable to the capital markets, and trust cannot exist without confidence in financial statements and other financial information. The availability of complete, reliable and comparable financial disclosures that fairly represent the financial position of a company is core to the ability of shareholders to make investment decisions. It is the steady flow of timely, comprehensive and accurate information that enables investors to make sound investment decisions. Our economies rely on fair, orderly, and efficient capital markets to raise and access financial resources; therefore, integrity of the information, which is the basis of investment decisions, is crucial to the efficient functioning of economies.

Executive compensation

The manner in which companies compensate top executives establishes the financial incentive structure that will help drive managers’ priorities for strategy, risk management and operational excellence. Shareholders, especially in the United States, are particularly interested in whether the structure of a compensation plan aligns the interests of management with the long-term interests of shareholders. While these financial incentives are only one source of motivation for management, the structures of compensation plans are informative because they signal the priorities of the board.

In addition, some shareholders are growing more concerned about pay levels (sometimes called the quantum) and in particular how CEO pay levels compare to the compensation of other company executives and employees, as well as to income in society as a whole. These shareholders view increasing economic inequality as a risk to the company and their investments more broadly.

CEO compensation is set by the board of directors, which delegates the drafting of the plan to its compensation committee. Each company is required to publish a description of its executive compensation plan, and the amounts of compensation for the top five executives, in a Compensation Discussion & Analysis (CD&A) statement within its proxy materials (Form DEF 14a). Many shareholders pay close attention to how clearly and explicitly the CD&A explains both how the plan works and how it supports the board’s strategy for creating the proper managerial incentives.
Today, executive compensation plans typically include a mix of salaries, cash bonuses, and some form of equity-linked compensation. The stated purpose of this structure is to balance three key objectives:

1. To attract and retain talent;
2. To align manager incentives with shareholder results and risk; and
3. To link managerial rewards to the achievement of strategic objectives.

A careful balance of all of these objectives is required to ensure that the best talent is employed to achieve excellence over the long term.

Each of the three objectives is important and distinct. In particular, the second and third perform complementary functions. Most shareholders believe that managers should share in the total return the company provides to investors, primarily through a stock price that rises over time. However, the value of even mediocre companies increases when the market as a whole is rising. Additionally, many important strategic objectives, especially those related to sustainability, may benefit companies only in the long term, and many ultimately damaging actions may offer a quick stock market boost. For these reasons, most effective compensation plans look beyond share price performance to incorporate additional measures of company performance as well, such as return on assets, market share, or customer or employee satisfaction.

The best plans base rewards and incentives on long-term business performance. Long-term performance is often understood as taking place over the full “business cycle”, or the periodic expansion and contraction of economic activity, during which company sales and profits may increase and decline. Because every company is unique in its risks, opportunities, and strategies, executive compensation plans are highly customized to particular companies. Plans include a mix of qualitative and quantitative measures, and many include a discretionary component to allow some flexibility to respond to unforeseen circumstances. Companies pay close attention to their peer group—its competitors and other companies that the board deems most similar to its own. Companies typically base performance targets, compensation components and sometimes even perquisites on peer group practices and levels.

Boards, and in particular compensation committees, should pay careful attention to the design of compensation plans because they are a key tool for strategic management and executive accountability to shareholders. Critical to this accountability is the dialogue that takes place between shareholders and companies regarding pay plans. While all shareholders in US companies have the opportunity to cast a non-binding vote on the pay plan, a simple up-or-down vote is insufficient to communicate shareholder concerns about this complex topic. Shareholder–company dialogue helps companies to better understand these concerns, and allows shareholders to better understand companies’ thinking and cast more informed votes. Some companies have begun to report on the feedback they are receiving from shareholders and how they intend to respond.
Does the way in which an executive is compensated matter?

J. Michael Pearson, CEO and Chairman of Valeant Pharmaceuticals from 2008-16, was compensated by a plan that tied his incentive pay solely to stock market performance and offered extraordinary rewards for success. Pearson received restricted shares only if company stock price performance increased by certain amounts over a three-year period. Pearson also was required to acquire $5 million in stock with his own money.

Pearson earned exponentially higher rewards the more Valeant’s stock price appreciated, but faced no potential downside if the stock price fell. More diverse measures of company performance such as profit or return on assets were omitted, as were non-financial measures such as the successful introduction of new medicines.

Pearson reduced Valeant’s internal research and development program, focusing instead on acquiring companies with promising products, raising the prices of these medicines and then marketing them aggressively. The company also completed a “tax inversion” – buying a Canadian company and then itself reincorporating in Canada – that reduced its tax burden from 36% to just over 3%. After two years, the company had already achieved share price performance sufficient for Pearson to receive the maximum payout under his plan.

Eventually, however, problems emerged. Some investment analysts began to question whether a company entirely dependent on acquisitions for its product line could sustain its performance over time. Others raised concerns about its accounting practices and debt levels.

The real problems began when people began calling their Congressional representatives to ask why the medicines had suddenly increased dramatically in price, sometimes leaving them unable to afford lifesaving medicines that had previously been a minor expense. Congress responded by questioning the company’s pricing practices, and concerns grew as the company’s failure to disclose the extent of its relationship or potential conflicts of interest with a pharmacy company came to light. By spring 2016, the company had lost 90% of its value and Pearson, battling health problems, resigned from the company. He took home over $100 million between 2008 and his resignation in 2016.

Did compensation play a role in this destruction of shareholder value? Was Pearson rewarded for boosting the stock price in the short term while putting the long-term viability of the company at risk?

And, as one industry expert put it: “Is the role of leading large pharmaceutical companies to discover lifesaving drugs or to make money for shareholders through financial engineering?” At the very least, did Pearson or his board not wonder whether a strategy of continually rising drug prices would eventually raise concerns among customers or regulators?

A company’s sustainability policies define its long-term relationships with outside stakeholders such as customers, suppliers, employees and society at large. Many companies consider robust sustainability policies to be a core strategy for managing risk, developing a productive corporate culture, and creating long-term value. Shareholders increasingly are evaluating corporate sustainability policies as a sign of companies’ overall approach to corporate governance and the quality of management teams.

Sustainability encompasses a wide variety of issues related to a company’s social and environmental impact. Shareholders and other company stakeholders may have specific concerns about a corporation’s behavior, such as its labor relations, greenhouse gas emissions, or diversity record. Shareholders may also consider the company’s overall approach to sustainability issues as a matter of general corporate governance. Many companies publish a sustainability report (or set of reports) that details their sustainability policies and practices. Some companies are also experimenting with “integrated reports” that incorporate sustainability metrics into traditional financial reporting.

In evaluating the quality of sustainability reports, shareholders should consider the following elements:

1. **Principles:** Effective sustainability reporting articulates a clear firm-wide sustainability strategy. Sustainability reporting should identify key stakeholders and understand the concerns of these stakeholders; analyze the business risks and opportunities related to key stakeholder relationships; and establish a set of goals for sustainability that are linked to overall business goals.

2. **Practices:** Sustainability reporting should explain how it intends to achieve its high-level objectives. While it is not necessary to publish a detailed operating manual, the company should explain how sustainability is managed at all levels of the company (including the board of directors); the incentives used to motivate sustainability performance; expectations of suppliers and other business partners; and any other methods the company uses to integrate its sustainability strategy into its operating model.

3. **Performance:** The company should make clear how it measures its progress towards achieving its strategic goals. Management should establish operational goals related to overall strategic objectives; establish (ideally quantitative) key performance indicators (KPIs) to measure progress; and where possible explain how these objectives are linked to the operating results of the firm.

**Sustainability:**
A company’s sustainability policies and the quality of its relationships with its stakeholders provide insight into its management of risk and capability to take advantage of opportunity in the long term.
The capital structure of a company is how the company funds its assets, operations and growth. The most common forms of financing are debt (long and short term) and equity (common stock, preferred shares and retained earnings). Capital structure is often expressed as the ratio of the value of the company's debt to the value of its equity.

Getting capital structure right is critical for managers because it can affect the risk profile of the company, the cost and availability of additional financing, the relative interests of different financial stakeholders, and the exposure that the company faces from market and economic forces. Given these complexities, shareholders are generally not in a position to set the optimal capital structure of a company. However, shareholders do have an oversight role in capital structure because their interests and their rights are at stake.

Closely linked to capital structure, shareholders are concerned about the voting rights that accompany ownership of shares, which provide important safeguards for the interests of shareholders, and the restructuring of capital through mergers and acquisitions.

Why is capital structure a key theme?

In 2007, Bear Stearns carried $36 in debt for every dollar of equity, a very high leverage ratio. In practice, this meant that the bank could make high profits in favorable market conditions, but would be at significant risk as the market turned down.

When the real estate market began to weaken, Bear Stearns had little financial cushion to protect itself from losses. Even though the company's exposure to this market was limited, its financial position began to deteriorate. Many of its investors and creditors began to lose confidence in the company, especially after the failure of two hedge funds with major exposure to sub-prime mortgage securities. This was a particular problem because Bear Stearns relied on short-term financing that had to be renewed as often as every day.

Once lenders began refusing to renew their loans, Bear Stearns faced a bank run (where depositors and creditors race to take their capital out of a bank) that depleted its capital and required it be saved from insolvency by JP Morgan Chase. In the end, JP Morgan Chase bought out the failing company for less than the value of its new Manhattan office building.

Voting rights, capital structure and corporate restructuring:
These technical matters help to maintain a proper balance of power in a company as well as ensure that strategic decisions are made with appropriate input from shareholders, boards and other stakeholders.
Cornerstone Capital Inc. doing business as Cornerstone Capital Group ("Cornerstone") is a Delaware corporation with headquarters in New York, NY. The Cornerstone Flagship Report ("Report") is a service mark of Cornerstone Capital Inc. All other marks referenced are the property of their respective owners. The Report is licensed for use by named individual Authorized Users, and may not be reproduced, distributed, forwarded, posted, published, transmitted, uploaded or otherwise made available to others for commercial purposes, including to individuals within an Institutional Subscriber without written authorization from Cornerstone.

The views expressed herein are the views of the individual authors and may not reflect the views of Cornerstone or any institution with which an author is affiliated. Such authors do not have any actual, implied or apparent authority to act on behalf of any issuer mentioned in this publication. This publication does not take into account the investment objectives, financial situation, restrictions, particular needs or financial, legal or tax situation of any particular person and should not be viewed as addressing the recipients' particular investment needs. Recipients should consider the information contained in this publication as only a single factor in making an investment decision and should not rely solely on investment recommendations contained herein, if any, as a substitution for the exercise of independent judgment of the merits and risks of investments. This is not an offer or solicitation for the purchase or sale of any security, investment, or other product and should not be construed as such. Investing in securities and other financial products entails certain risks, including the possible loss of the entire principal amount invested. You should obtain advice from your tax, financial, legal, and other advisors and only make investment decisions on the basis of your own objectives, experience, and resources. Information contained herein is current as of the date appearing herein and has been obtained from sources believed to be reliable, but accuracy and completeness are not guaranteed and should not be relied upon as such. Cornerstone has no duty to update the information contained herein, and the opinions, estimates, projections, assessments and other views expressed in this publication (collectively "Statements") may change without notice due to many factors including but not limited to fluctuating market conditions and economic factors. The Statements contained herein are based on a number of assumptions. Cornerstone makes no representations as to the reasonableness of such assumptions or the likelihood that such assumptions will coincide with actual events and this information should not be relied upon for that purpose. Changes in such assumptions could produce materially different results. Past performance is not a guarantee or indication of future results, and no representation or warranty, express or implied, is made regarding future performance of any security mentioned in this publication. Cornerstone accepts no liability for any loss (whether direct, indirect or consequential) occasioned to any person acting or refraining from action as a result of any material contained in or derived from this publication, except to the extent (but only to the extent) that such liability may not be waived, modified or limited under applicable law. This publication may provide addresses of, or contain hyperlinks to, Internet websites. Cornerstone has not reviewed the linked Internet website of any third party and takes no responsibility for the contents thereof. Each such address or hyperlink is provided for your convenience and information, and the content of linked third party websites is not in any way incorporated herein. Recipients who choose to access such third-party websites or follow such hyperlinks do so at their own risk.

© Cornerstone Capital Inc. 2016
A Voice in the Boardroom (Executive Summary): Practical guidance for voting proxies to influence corporate governance, sustainability, and performance

Published July, 2016