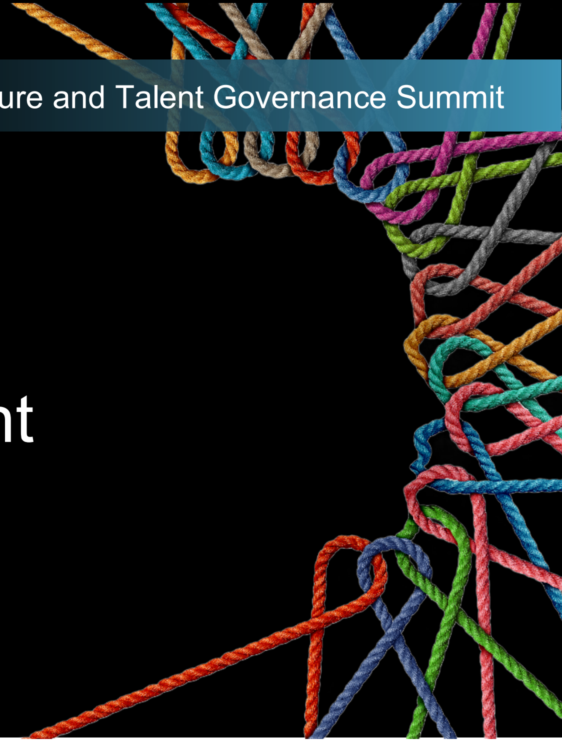
Culture and Talent Governance Summit



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SUMMARY OF THEMES

Leadership and culture oversight take center stage for boards

November 2024

A company is caught after many years of misconduct, forcing its leaders to recover a shattered corporate reputation. Executives worry that even rich financial packages are no longer enough to retain talented employees. Boards wonder whether it is safe to take a public position on socially divisive issues. On October 17, Tapestry Networks' Culture and Talent Governance Summit brought together board members and senior executives to discuss corporate culture, talent management, and executive compensation.

Special guests included an executive from CMPC, a multinational pulp and paper company; partners of Meridian Compensation Partners, an independent executive compensation consulting firm; and a managing director from Edelman, a global communications firm.

For a list of meeting participants, see appendix (page 6).

This *Summary of Themes* highlights boards of directors' focus on new strategies for overseeing culture and human capital in an evolving workforce, labor market, and geopolitical landscape:

Rebuilding corporate culture after a crisis

In 2016, CMPC (Compañía Manufacturera de Papeles y Cartones), a multinational pulp and paper company, faced revelations of extensive misconduct. A small group of executives had established what was later known as the "tissue cartel," collaborating with competitors to set prices and market share quotas for personal care products. For over a decade, CMPC played an important role in organizing and sustaining the cartel. These executives and their competitors met in secret to share information and established clandestine means to exchange strategic information.

What led to the scandal

Changes in the competitive landscape put pressure on CMPC to maintain its market share. "*It started with new companies entering the market, bringing lower priced products which changed the business context*," said Carlos Villagrán, Director of Risk & Compliance for CMPC.

Mr. Villagrán emphasized that several factors created conditions where misconduct could spread.

- **A culture of performance at all costs**. Mr. Villagrán said that aggressive business practices crossed a line into misconduct. Leaders focused on what was working, and as long as a unit was delivering results, they did not ask questions about how those results were achieved.
- **Misaligned incentives**. Executives had strong incentives to succeed, and much of their compensation was linked to sales growth. Even more important were promotions, which brought status and access to influential social circles.
- **Lack of speak up culture**. According to Mr. Villagrán, only a few people were actually involved in running the cartel. But although many more knew of or heard rumors about misconduct, no one raised a hand. CMPC's culture discouraged employees from challenging management, and many feared retaliation or believed that the company would not investigate their claims.
- **Shortcomings of governance and organizational structure**. Silos within the organization limited transparency and prevented individuals from gaining a clear understanding of overall operations. Different segments developed distinct cultures and practices, including around compensation, and CMPC's aggregate risk assessment methods were poorly equipped to spot how competitive pressures could affect ethical behavior.

When the misconduct came to light, CMPC faced significant financial penalties including fines and restitution to consumers. But reputational damage far exceeded any financial consequences. The firm was widely viewed as corrupt, and media coverage marred its reputation, amplifying the shame experienced by company employees, even those who were not part of the misconduct. The public responded with protests, discarding CMPC products in supermarkets and targeting employees wearing CMPC uniforms. The scandal made some clients reluctant to do business with CMPC, and the firm struggled to attract and retain talent.

Restoring trust and integrity

CMPC set about rediscovering its core values and rebuilding a culture of integrity. While Mr. Villagrán acknowledged that this process is by no means complete, he highlighted actions the company has taken:

- **Replacing leadership and talent.** "*CMPC's response focused on changing the board and leadership,* *aiming to bring in more diverse perspectives and ideas. The company actively sought out new voices to drive this change*," said Mr. Villagrán. The process was not easy; rebuilding a culture of integrity by changing leaders required tough choices and created real pain within the company.

- **Fostering transparency through vulnerability.** Rediscovering values began with open conversations to promote transparency, Mr. Villagrán said. *"CMPC held town halls for local employees explaining the scandal and allowing them to ask questions*." He acknowledged that these conversations were not easy: "*It got messy because many people wanted to take the microphone and speak with us, but rediscovering our values started with those conversations. And transparency became real. Now, transparency is measurable through surveys and hotlines.*" Vulnerability – admitting wrongdoing and acknowledging failures rather than covering them up – became a crucial driver of transparency.
- **Transforming language around misconduct**. Mr. Villagrán explained, "*We needed to reshape the language surrounding corruption to convey that the understanding of what is legal or acceptable can vary, and that corruption fundamentally constitutes an abuse of power*." He emphasized that definitions of corruption differ, and the language evolves to reflect how the perception of corruption has changed over time. In this context, altering the language was crucial for transforming the culture, inviting conversations such as, "*Do you understand what is wrong?*" and "*How can we work together to address it?*"
- **Making a commitment to sustainability.** As part of its cultural transformation after the crisis, CMPC has embraced sustainability, integrating into every aspect of its operations, from forest management to production processes. As a result, CMPC has been recognized for the last two years as the most sustainable company in the pulp and paper goods sector on the Dow Jones Sustainability Index. Company leaders believe this commitment will strengthen its position in the market and demonstrate that social and environmental responsibility can go hand-in-hand with financial performance.

Compensation, the war for talent, and new workplace dynamics

"It's essential to consider how external factors are reshaping the approach to executive compensation,*"* said Meridian's Darren Moskovitz. Beyond such drivers of change as regulators, shareholders, and activists, other market conditions are reshaping the compensation and talent landscape. These include the impact of politics, competition for top talent, and mounting pressures around diversity, equity, and inclusion. *"Things are getting more complex, not less*,*"* Mr. Moskovitz said.

Participants discussed their views and new approaches to compensation and talent strategy:

- **Linking pay to performance and strategy remains a priority and a challenge.** Compensation committees are striving to link compensation both to performance and to specific strategic and operational priorities. Mr. Moskovitz said, *"Compensation has to tie into your strategic plan and the goals of the corporation, and compensation structure should flow down from the CEO to the executive leadership team. You have to make sure that what you're doing ties to the organization's goals, not just what your peers are doing."* This can mean tying compensation to operational goals in addition to financial performance, especially when companies are facing difficult market conditions. *"Lots of* *companies are trying to turn themselves around but aren't delivering results that shareholders want. How do you compensate executives for that?"* This may require organizations to push back against rules set by investors and proxy advisors in order to link compensation to specific operational and strategic objectives. *"Sometimes the things frowned upon by ISS and Glass Lewis are actually beneficial for the company,"* one director said. Virginia Rhodes, another expert from Meridian, stressed that effective engagement is crucial in those cases: *"If you step outside the lines knowing that you'll get pushback, but you have good engagement with shareholders, yes, you'll be in the penalty box but it's recoverable. If you fail say-on-pay in one year, it is critical to engage and understand the concerns of your investors and make changes accordingly. This responsiveness is expected, which is hard work – but can lead to improved results in years following lower support."*

- **Deep-pocketed rivals are luring away top talent.** In the ongoing war for top talent, Mr. Moskovitz noted that the rising influence of private equity is intensifying competition. A compensation chair of a public company agreed, saying, *"Private equity is who's paying people a ton. And tech takes a lot of the best talent."* The challenge is particularly acute for the public sector. An executive remarked, *"The differential between pay in the private sector and pay in the federal government is getting so difficult that the smartest people are leaving, and if they're staying, they're taking on other jobs which creates conflicts of interest."*
- **In retention, other factors now overshadow compensation.** Compensation is no longer the sole or even the primary motivator for employee retention. "*We're discovering that developmental opportunities and leadership engagement are sometimes more valuable to employees than financial incentives. If you overlook culture, professional growth, and career advancement, your top talent will easily be lured away by competitors*," said Ms. Rhodes. Even large long-term incentive packages may not be enough to retain talent. Some participants noted that promotions and title adjustments—even if they come with no increase in pay—can be better tools for retention than compensation.
- **Employees are prioritizing mobility over stability.** *"When I was growing up the main thing was stability, now it's mobility. People are more focused on building a career rather than just holding a job, so they value portability,"* said a director. In today's workplace culture, employees seek career paths that allow them to explore new experiences, and many are reluctant to commit to long tenure with any single organization. An executive noted, *"Individuals have even turned down retention bonus offers because they don't want to feel obligated to stay; they want the freedom to choose when to leave."*

Summit participants said we are facing a pivotal moment for adapting to workforce changes**.** "*It feels like we're about to miss this opportunity to reinvent the workplace because at the leadership level there is an unwillingness to adapt*," said an executive. Participants agreed on the need to listen to employees, embrace work-life balance, and consider options: side gigs, a four-day work week, and remote or hybrid work. However, they warned, some leaders may be reluctant to listen and respond. "*We may be overlooking a critical opportunity to hear the labor market's concerns about work culture. I don't see leaders seeking feedback from the workforce. We're trying to fight with the last tool rather than reimagining what work could be like. This could be a moment of real creativity, but we keep trying to go back to the past*."

Navigating complex social issues

Corporations are grappling with rising social and geopolitical tensions, including extreme polarization and the politicization of a wide range of issues. These challenges are reshaping corporate culture, influencing employee retention, and affecting public trust in leadership.

Edelman's Sean Neary discussed how companies can navigate and effectively respond to the current social and political environment:

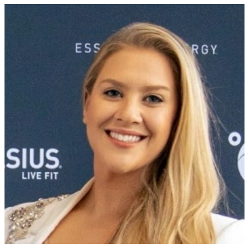
- **Stay mindful of business' status as a trusted institution.** Edelman's 2024 Trust Barometer reveals that businesses are the most trusted institutions, surpassing government, NGOs, and media. Employees rely on information from their employer, according to Mr. Neary: "One of t*he most trusted sources of information is your company newsletter.*" But because of this shift, employees increasingly look to their companies to support social and political concerns they care about.
- **Carefully consider whether and when to take a position.** Consumers, as well as employees, pressure businesses to speak out on political and societal issues, believing that a company that doesn't communicate its values or its actions is indifferent or hiding something. Nonetheless, Mr. Neary said that organizational leaders should not rush to respond to every emerging issue. Take time to evaluate a response and consider that saying and doing nothing can often be best. When corporations do speak out, they must be sure they can take actions to back up their words. "*The key is not to react hastily but to first assess whether meaningful action can be taken before making any statements,"* he said.
- **Align with the specifics of the business.** Each company's response to a societal issue must be tailored to its unique circumstances. *"It's not always about staying silent; it's about being thoughtful*," said Mr. Neary. In deciding whether to engage on a specific issue, organizations should consider their core values, the characteristics of their employees and customers, and the markets and geographies in which they operate. Companies must carefully evaluate their capacity to drive change while maintaining a consistent message that balances the interests of shareholders, consumers, and especially employees. Mr. Neary explained, *"Your employees are your number one stakeholder. You won't please everyone, but staying true to your company's values is essential, as your workforce shares the same vision."* Engaging in regular pulse surveys, polling, and focus groups can help gauge employee sentiment before taking broader action.

The idea of values-driven leadership that listens to employees and responds to a shifting talent environment sounds attractive but is challenging in practice. Nevertheless, directors and executives continue to seek solutions, aware that their companies' sustainability is at risk.

Participants

The following members participated in all or part of the meeting:

Noni Abdur-Razzaq
Associate
Tapestry Networks



Danielle Babich
Senior Vice President, Human Resources
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Eric Baldwin
Executive Director
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Jim Byrne
Vice President, Corporate Ethics and Business Conduct
Lockheed Martin

Marjorie Rodgers Cheshire
Principal and Co-Owner
A&R Development Corp
Non-Executive Director
Exelon and PNC Financial Services

Tracy Davis-Bradley
Executive Director and Chief Integrity and Compliance Officer
U.S. Department of Veterans Affairs

Marsha Ershaghi
Managing Director
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Antonio Fernández
Chief Ethics and Compliance Officer
FirstEnergy

Denise Galambos
Chief Human Resources Officer
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Lisa Gersh
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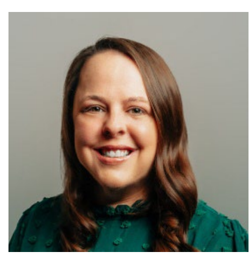

Laura Koski
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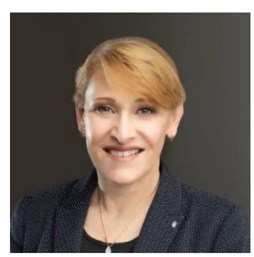

Katharina McFarland
Non-Executive Director
SAIC

Participants

The following members participated in all or part of the meeting:

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Darren Moskovitz
Partner
Meridian Compensation Partners

Sean Neary
Managing Director, US Co-Lead, Financial Services
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Virginia Rhodes
Partner
Meridian Compensation Partners

Joyce Russell
President
Adecco Group Foundation
Non-Executive Director
Celsius Holdings

Amanda Sourry
Non-Executive Director
Kroger, Olam Food Ingredients, and PVH

Kim Urbanchuk
Chief Compliance Officer and Deputy General Counsel - Compliance
Covington & Burling LLP

Carlos Villagrán
Director of Risk and Compliance
CMPC

Summary of Themes reflects the network's use of a modified version of the Chatham House Rule whereby names of members and their company affiliations are a matter of public record, but comments are not attributed to individuals or corporations. Italicized quotations reflect comments made in connection with the meeting by network members and other meeting participants