

Career Path: Do You have Skin in the Game?

Career Development

Corporate, Securities, and Governance



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One of the main benefits I got from my ACC membership was completely unexpected. It came from realizing that my fellow in-house colleagues were facing all the same problems as me. No one had a perfect solution to their problems, and we were all muddling along doing the best we could.

In fact, some colleagues had it far worse than me: those whose companies sold products to end consumers, so-called B-to-C companies. It seems like not a week went by when I didn't say to myself, "Thank goodness you don't have to deal with the individual public as customers." Prompted, of course, by some idiot suing a consumer goods company on transparently frivolous grounds. Or even when it appeared there might be a sliver of merit, then suing for such inflated amounts that I could never forget where the phrase "deep pockets" came from.

And this was years before the whole environmental, social, and governance (ESG) movement became front-page news. These same companies that had widespread brand recognition were natural targets for the early activists. A shareholder proposal at Coke or *Nestlé* got you much more publicity simply because everyone recognizes the name of your company. Still today, the nature of your customer and shareholder base is a great predictor of whether and what types of shareholder proposals will pop up during proxy season.

Working for a B-to-B company that nobody in the public had any reason to know or care about was a

great advantage. Yes, my in-house friends at Starbucks and McDonalds ran out of business cards at every ACC Annual Meeting. But I read the headlines like everyone else and consoled myself that it is better to be unseen than in the spotlight, at least if you're in-house counsel.

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We had our share of issues, no doubt. Many of our customers were big, powerful companies, much more capable of vigorously defending their interests than any individual consumer. And because these customers bought large amounts of products, when something went wrong, it was almost always worth pursuing.

Just doing business

Here's the lovely thing about B-to-B businesses: Neither companies nor their business customers have any incentive to push frivolous lawsuits. We just want to do business on reasonable terms. We typically have long business relationships and want to preserve the relationship. So when a problem arises, it is in both our interests to find a quick, fair solution. When a business customer decides to sue a supplier, the customer pays for it in the long run. What all this means is that B-to-B companies' and customers' incentives are aligned. We want to make the best possible products and sell them for a fair price. Customers want to buy the best products for a fair price.

Lawsuit happy

Now consider the B-to-C relationship. When you buy a treat from *Nestlé* or Kraft, you are not forming a meaningful, lifelong relationship with either company. But if you chip a tooth snacking on a cracker, some plaintiff's lawyer will slither out and tell you that you can get thousands of dollars. And best of all, it won't cost you a thing!

In this case, your incentives are not aligned with the company's, and are rather exactly opposed. You have no downside risk (also known as "skin in the game") because you suffer no costs if you lose. It's all upside to you.

> ... Senior management create your greatest exposure.

Your lawyer similarly has almost no skin in the game. True, they need to file a lawsuit, but this is something they've done many times before. They simply change the plaintiff's name on their standard form complaint, update their outrageously overbroad list of requested discovery subjects and topics, and the costs and burdens shift to the company.

Your lawyer knows that the cost of defending even frivolous lawsuits is so high that companies make the economically rational choice to settle many of them. What is a nuisance settlement for *Nestlé* is bread and butter to your lawyer: 40 percent of US$30,000 for doing little more than printing off a copy of a standard complaint is easy money. So it's all upside to your lawyer as well.

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Playing the incentive game

This mismatch of incentives explains a great deal of what in-house lawyers do. Look for where one party has greater upside than downside or a potential gain with little cost and you will find the sources of bad behavior. Let's assume salespeople are compensated based on the volume of new business they bring in. Will they care as much about the terms of the contract as they will landing a new customer? You know the answer.

Your greatest risks

Looking at who has skin in the game helps you identify your greatest compliance risks. Next, look at how material are the risks that the individual can cause by their actions. No matter what type of company you work for, this analysis usually leads you to the conclusion that **senior management create your greatest exposure**.

Senior management have tremendous upside, which encourages them to take risks. They are often well-insulated against downside risk. Yes, they may be dinged on their cash incentive one year, but their long-term equity incentives still pay off handsomely. Thus, they have insufficient skin in the game.

The time in-house counsel spend rolling out compliance programs to every employee worldwide is largely for show. If we're honest, it's partly a distraction by management to deflect attention from their own incentives for mischief.

> Looking at your compliance program, ask yourself this question: How much time do you spend on window-dressing versus designing incentives tailored to your greatest risks?

In-house counsel's incentives are usually properly aligned with the company's. That is, we don't want compliance problems and we feel the consequences when they occur. Looking at your compliance program, ask yourself this question: How much time do you spend on window-dressing versus designing incentives tailored to your greatest risks?

Question, comment? Contact Career Path columnist James Bellerjeau.

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