When the Shutdown Ends, the Hard Work Really Begins: Actionable Insights for Boards and Senior Management

Updated 22 July 2020

Last month, the Governance & Sustainability Center, in partnership with Russell Reynolds Associates and Debevoise & Plimpton, released a groundbreaking report, *Corporate Governance Challenges in the COVID-19 Crisis*, based on a survey of 236 companies (respondents were comprised of general counsel, corporate secretaries, and investor relations executives).

The results revealed that in the first "shutdown" phase, boards and governance professionals stepped up to address the crisis – increasing communication and focusing on the urgent topics that mattered most. But the next phase will be even more challenging, with a growing list of items that need to be addressed in the near term and have long-term implications.

You can read the full report here, but here are some of the most pertinent findings:

Initial Phase

Boards and senior management teams ramped up their efforts, focusing on what mattered most when the health and economic crisis began

- 58.5% of companies held special board meetings, 52.5% communicated with their board at least weekly, and 81% designated a director to serve as the key liaison with management, on COVID-19

- The issues identified most frequently as the top three for the board's attention at companies of all sizes and across industries, were: liquidity, employees, and operations.

Current Phase with Long-Term Impact

Boards now need to expand and shift priorities.

- The top issues of liquidity, employees, and operations will not go away.
- But the issues mentioned least frequently among the top three: customers, cybersecurity, and corporate social responsibility will need to move up the list - and fast, requiring new types of reports to the board.

Companies should consider revising business continuity plans, expanding their crisis management team, and updating executive succession plans.

- 28% did not have a C-Suite-level crisis management team, and of those that do, only 46.7% of companies have HR and just 33.7% have the risk management function represented on their teams – areas that will be key to future planning as businesses reopen.
- 63.2% of respondents considered their business continuity plans inadequate (and only about half have updated them thus far), meaning there is more work to do.
- 60% stated that they had not reviewed or updated their CEO and executive succession plans.

Most companies have withdrawn or revised their earnings guidance, creating a potential investor relations vacuum.

- More than 60% of companies have withdrawn their earnings guidance since the beginning of the crisis—their quarterly guidance (5.5%), annual guidance (23.7%), or both (33.9%).
- The information gap needs to be filled – not only with investors but also with other stakeholders – through a level of sustained transparency during the reopening phase and beyond.
- Companies are sharply divided on how COVID-19 will affect their sustainability program, and each company needs to come to a consensus view on the impact and communicate it soon.
- Over 30% see the pandemic having a negative impact on sustainability efforts: 12.3% believe that the crisis will decrease the overall emphasis on sustainability, and 18.6% believe that it will put sustainability efforts on temporary hold.

- Only 10.2% think that it will increase the overall emphasis on sustainability at their company. The largest share, 37.7%, expect a shift in the priorities of those programs.
- As institutional investors and other stakeholders continue to press forward with their focus on ESG issues, companies should carefully assess the impact of the pandemic on their sustainability initiatives, and promptly communicate any updates to their investors and other stakeholders.

While a growing number of companies are cutting executive salaries and expect bonus amounts to be impacted, most companies are moving cautiously in changing the performance metrics used for executive bonuses and performance-based equity grants.

- As of May 2020, 12% of companies have reported cuts to base salaries, and 39% expect the crisis to affect their executives' bonuses; by contrast, 70% are not planning changes to equity grants, and nearly two-thirds are not expecting changes to cash incentive programs.
- As companies adjust equity grants or to performance metrics associated with executive compensation, they should proceed cautiously and be mindful of the full potential impact of the pandemic, investor views, and the company's broader sustainability strategy. Compensation committees will want to make sure they have a full picture of the impact of the crisis on the company and to gauge the potential reaction from investors and other stakeholders, before adjusting performance metrics or equity grants -- to avoid a backlash from investors in next year's say-on-pay votes and damage to the company's reputation.

COVID-19 has made small public companies especially vulnerable. While this pandemic has revealed vulnerabilities at all companies, it has exposed more widespread challenges at smaller companies.

- For example, more than a quarter of small companies (27.5%) did not have business continuity plans, which left them relatively unprepared when the crisis hit them. This is ten times the rate of large companies (2.7%) without a disaster preparedness plan.
- 35% communicated with their boards about the crisis at least weekly, compared to 62% at large companies.
- Smaller companies will want to promptly address the broader governance vulnerabilities exposed by this pandemic, which may increase their risk of becoming targets of shareholder activism.

In a recent *ESG Watch* – now available on demand, we had the opportunity to delve into the findings mentioned above and discuss a preview of our upcoming report on Board Practices in the Russell 3000.

Some of the insights from the discussion included:

- ***Sustain a higher frequency of board communications and meetings***. Consider holding informal calls with your board members on a regular basis. With companies facing the combination of health, economic, and social crises, and an even longer list of topics for the board to consider during this reopening phase, an ongoing high level of engagement with your board is critical.

- ***Use your existing reporting and monitoring processes***. As companies provide more information to the board, it is probably a good idea to leverage your existing reporting and monitoring processes wherever possible. You may wish to add metrics (e.g., more detail on employee health and safety), and you may want to consolidate information in a COVID-19-related dashboard, but you probably have robust processes in place to collect, verify, review, and report information to the board. You will want information going to the board (and potentially to external constituencies) related to COVID-19 and other crises to have the same degree of reliability.

- ***This is a time for CEOs to engage with empathy***. It’s common for there to be turnover in the CEO’s office a year or two after a crisis hits. Boards are likely to take a close look at whether their CEOs demonstrated the skills and qualities that enabled them to engage effectively with multiple stakeholders, and with empathy. Even as we eventually move beyond COVID-19, those are likely to continue to be key requirements for the corner office.

- ***Ask your investors for their expectations in addressing social issues***. It is easy, when you have a shareholder proposal on a topic such as diversity or equity, to focus on the shortcomings of the proposal itself. But it can pay real dividends to ask your investors, regardless of the language of the proposal, what they believe you should do on the topic being raised.

- ***Board diversity is an urgent topic now – and there are concrete steps companies can take***. It’s helpful for boards to expand their aperture in the director search process to look not just for a sitting CEO or CFO, but rather for a “senior executive” who brings a set of skills and qualities that will make them an effective all-around member of the board. And it’s helpful to provide customized onboarding programs, especially if you’re recruiting a director who has not served on a company board before. Boards that primarily rely on heir existing networks of contacts when looking for a new director will likely find it harder to diversify.

AUTHORS

Paul Washington

President and CEO
Society for Corporate Governance

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