

Shareholder Engagement: A strategic lever of Corporate Governance



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With the recent increase of shareholder activism, a competing paradigm of shareholder democracy has emerged in which shareholders demand increasing input on decisions that, under the old paradigm, unquestionably would have remained in the purview of the board's or management's business judgment. This trend is part of a new paradigm in the corporate governance realm. Shareholder engagement refers to all the ways that shareholders can communicate their views to the board and that boards can communicate their perspectives to shareholders (in addition to existing investor relations activities and processes). As part of a growing, international trend, many shareholders want to increase their engagement with boards.

In today's corporate governance environment, shareholders increasingly desire a forum and opportunity to communicate with companies on a wide range of matters. Shareholder engagement and participation that contributes to good corporate governance has two main features: 1. Shareholders being well informed about the companies in which they invest through

effective communication; that is, transparent reporting of company information and meaningful dialogue between shareholders and company boards; and 2. Shareholders being able to perform their accountability role by exercising their voting entitlements effectively.

Shareholder communications is a fundamental and long-standing aspect of the board's fiduciary oversight responsibility. Directors are obligated to provide shareholders with the information they need to reach reasoned decisions on corporate governance matters and issues of fundamental importance to the company's future. However, boards are under rising pressure to engage more frequently and meaningfully with shareholders and provide more information to shareholders and other stakeholders on how the business is run. At the same time, traditional means of communicating with shareholders are becoming increasingly anachronistic and ineffective.

The Benefits of Engagement

Better shareholder engagement has the potential to provide useful information to the

board, improve the company's relations with its shareholders, and increase shareholder value. Shareholder engagement practices can also enhance board credibility and increase shareholder's goodwill and trust — which can make the difference when the company is facing a proxy fight or crisis. Some of the ways boards can benefit from communications with shareholders are as follows.

- Shareholder views can provide an external measure of company performance. These views may be valuable in fine-tuning strategies and as a source of potential early warning signals. As many short- and long term factors affect stock trading prices, company stock price should not be the sole barometer for shareholder views on company performance. Moreover, information regarding shareholder views on compensation, company and executive performance, environmental responsibility and other matters can counter-balance management's influence on such matters.
- Effective shareholder engagement practices can provide comfort on the "tone at the top", and increase the goodwill and trust of shareholders.

Indeed, giving shareholders a chance to voice their concerns early can reduce friction and perhaps avoid shareholder proposals and proxy fights, which are often initiated to establish dialogue with boards. In addition, when institutional shareholders and their advisory services publish views that are critical of the approach adopted by the company, shareholder goodwill built through effective shareholder engagement may lead other shareholders to give the company's perspective more credence.

- It helps the corporates to better understand shareholder concerns that they can either better incorporate into their policies and practices or otherwise be better equipped to respond to those concerns.
- Enhanced shareholder engagement gives corporations the ability to educate their shareholder base. Such engagement provides corporations with the opportunity to explain their perspective and policies in a manner that could prevent misunderstandings. It also enables the board to provide information to shareholders so that they can make more informed decisions. Given that shareholders now have a voice over a range of corporate governance decisions, this educational role is vital.
- Engaging with shareholders could generate goodwill among the shareholder base that creates allies that may help repel takeovers or efforts from those seeking to threaten or undermine corporate policies. Indeed, if shareholder engagement increases the likelihood

that shareholders will view management and their policies favorably, it also reduces the ability of other shareholders and even proxy advisory firms to influence the actions of their existing shareholder base. In other words effective shareholder engagement can translate into shareholder support in times of turmoil.

Shareholder Engagement Policy

A formal policy for shareholder engagement setting out the company's policies with respect to the receipt and handling of communications with shareholders, including shareholder requests for direct communications with directors can set out the ground rules for communications. Such a policy should address the following elements.

- Articulate the board's approach. A policy should articulate the board's philosophy respecting shareholder engagement and the allocation of responsibility for shareholder engagement between the board and management.
- Criteria for shareholders. If the board chooses to engage with different categories of shareholders in different ways, the policy can describe what forms of engagement are generally available to differing categories of shareholder.
- Clarify the agenda in advance. The policy can let shareholders know what topics may or may not be discussed within the framework of allowable issues and that it will be necessary to clarify these further in order to avoid discussion on areas that

might give rise to fair disclosure concerns and to allow for advance preparation.

- Confirm when counsel or the IRO will be present. The presence of internal or external counsel and/or the Investor Relations Officer can help ensure that all parties respect the ground rules. Counsel or the IRO can also step in if the conversation appears to encroach on areas that might give rise to fair disclosure concerns.
- Process to address specific shareholder concerns. The policy can stipulate that directors speak only to their area of responsibility. For example, the policy can specify that only the representative of the Compensation Committee may engage with shareholders on executive compensation issues. The policy could address the need for directors to clarify when they are expressing personal opinion rather than the company's position.
- Conduct a post-meeting review. A debriefing with corporate participants immediately following the meeting can identify any selective or misleading disclosure so that prompt public dissemination of the information can be pursued in accordance with the established disclosure policy and continuous disclosure requirements.

Articulating ground rules for board provides a reference point when certain requests will not be honored that may reduce the likelihood that a shareholder whose request has been turned down may view the decision as reflecting a disregard for shareholder concerns, a personal bias or an

indication of a possible lack of independence by directors.

Guidance for Shareholder Engagement

The discussion about direct shareholder-director engagement has never been livelier. Large institutional investors have articulated their desires for increased shareholder-director engagement. As more investors become interested in the prospect of communicating directly with boards, it is important to consider the framework for those discussions.

- A screening process should take place to determine which shareholders to engage. In determining whether to meet with a requesting stockholder, directors should consider a variety of factors, including the topics proposed for discussion, what the company can expect to achieve as a result of the engagement, the requesting stockholder's profile, the company's vulnerability to an activist campaign.
- How do you decide who does the engagement? If the board determines that directors should meet with stockholders, they then need to decide who should participate in the interaction. The board should select the directors based on the specific topic to be discussed and the directors' experience, expertise, and board role, determine whether any of the company's executive officers should participate in the engagement, select a director or member of management to be responsible for coordinating the engagement.
- How should you prepare for

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the engagement? In preparation for the meeting, participating directors should, review relevant materials concerning the stockholders and the topics to be discussed, be advised of any sensitivity as seen by management, seek appropriate training on legal and business issues relevant to the subject matter of the engagement, coordinate the message points with management and the board as a whole to avoid confusion or contradiction in the company's public posture.

- The board also needs to consider the relative knowledge of management and directors on topics for discussion with shareholders and the capabilities and experience of those individuals who may be involved in responding to shareholder inquiries. Directors may require additional preparation and education regarding the company's stated position on topics they may be asked to engage in with shareholders and on the limits to permissible disclosure.
- Boards need to be sensitive to differences among shareholder views on engagement. Shareholders are not homogenous. Their motivations for engaging with the board, their appetite for engagement and the topics on which they wish to engage vary with the level of their investment, their investment time horizon, their personal interests. Companies must tailor their shareholder engagement practices accordingly.
- Walk into every meeting with clear goals in mind. Better yet, get the investor to articulate their own agenda as well. Know exactly what each of you wants to get out of the meeting and then get down to business
- Too often, companies spend too much time just trying to determine what not to say in meetings with investors and not really enough time working on what they want to communicate. This mistake leads to frustration and missed opportunities, not to mention a reduced likelihood that it can get an audience again. Every investor meeting is an opportunity



to better refine or explain your corporate growth.

- **Remember it's a two-way street.** It's important to have a dialogue between the board and shareholders. Even if opinions differ, there might be some strategic insights learned from the discussions
- **Don't assume passive investors are passive.** Treat your passive investors like anyone else. You may be surprised at how active they are.

Enhancing Shareholder Engagement

There are many innovative ways to enhance stakeholder engagement. Companies worldwide are taking new and innovative steps to enhance their outreach to shareholders and are developing more comprehensive investor relations strategies. Boards should evaluate their existing shareholder engagement practices and consider whether improvements may be made. Some suggested enhancements and their merits are discussed below.

- **Improving the Quality of Written Disclosure:** Public companies are required to prepare, file and/or distribute large (and growing) volumes of written disclosure materials respecting

their business, operations and financial results. While these materials must meet form requirements, must not contain a misrepresentation and may need to include cautionary language, all too often the result is disclosure that is lengthy, badly organized and difficult to read. Poor written materials are less likely to be read or understood by shareholders, and they may perceive that the company is not being candid. Shareholders crave communications that are clear, logically organized and easy to read. Merely improving the quality, rather than the quantity, of written disclosure to shareholders can increase shareholder confidence and goodwill.

- **Web Communications (webcasts, podcasts and video):** Corporate websites have become essential tools for broadcasting a company's information and messages to shareholders. Websites offer an opportunity for directors to become better known to and appreciated by shareholders. Video presentations for shareholders should be improved giving users the option to read and download a transcript of the video content. Some shareholders would rather review such comments from corporate executives in print as well as or instead of on video. Tools already exist to increase the media through which the annual report and other mandatory corporate governance disclosure is accessed by shareholders and to make the experience of viewing the information contained in them more personal or and interactive.

- **Shareholder Surveys:** Easy-to-use Internet-based polling technologies have increased the use of surveys and questionnaires as cost-effective and fairly rapid means to foster increased communication with target audiences. This technology has begun to find its way into investor relations and shareholder engagement efforts.
- **Board Blogs:** While the use of corporate blogs has grown substantially in the past few years, and blogs by senior management are growing in number, there appears yet to be few instances where such blogs are authored or consistently used by board members. Technology companies appear to beat the forefront in adopting this type of shareholder outreach, and the use of video blogs (or "vlogs") is becoming more common as access to broadband and high-speed Internet services becomes more widespread.
- **Governance Roadshows:** The idea of having senior management travel to various cities to meet face-to-face with existing and potential institutional shareholders is not new. Such roadshows typically form a major portion of most investor relations strategies, and they often occur following the release of financial results or a strategic announcement. More recently, shareholders have sought to better understand some key governance issues such as compensation policies, director election procedures, board compensation, succession planning, risk assessment and other issues believed to influence valuation. The time and cost of conducting a governance

roadshow, not to mention the logistical difficulties of finding a suitable date and venue, may make this option impractical for most companies.

- **Fifth Analyst Call:** Another vehicle for additional shareholder engagement has recently been introduced in the United States. A group of major shareholders from North America, Europe and Australia have proposed an idea that they call a “fifth analyst call,” which is a conference call hosted by companies in the same manner as the four quarterly earnings calls held by management for analysts. The initial concept is to provide shareholders with an opportunity to interact with the Directors and management of the company on issues beyond the financial numbers.

Continuous engagement

Now more than ever, institutional investors and other shareholders seek engagement to ensure their voices are heard and that companies and their boards in particular

are responsive to shareholder concerns and priorities. In its most effective form, shareholder engagement is a proactive process utilized by companies on an ongoing basis throughout the year.

An Important Caveat

Shareholder engagement can be effective under the right circumstances, but engagement is not a panacea or an end unto itself. Engagement is a desirable strategy when in the interests of all shareholders. In other circumstances, companies may wish to eschew engagement. For example, shareholders may sometimes advocate an agenda for their own benefit at the expense of other shareholders. As a result, companies should adjust their engagement strategies in light of their particular circumstances

Conclusion

Once considered a perfunctory exercise, designed to simply answer routine questions on performance or, occasionally, drum up support for a corporate initiative,

shareholder engagement has become a strategic imperative for astute executives and board members who are no longer willing to wait until the annual meeting to learn that their shareholders may not support change of some sort, or their strategic direction. Shareholders both large and small are exerting their influence to demand a greater role incorporate decision-making. This is more than a passing fad—it’s an international trend with many proponents and lots of momentum. Done right, shareholder engagement can provide directors with a better perspective on shareholder views. By increasing transparency in a manner consistent with the company’s disclosure controls and procedures and communication program, shareholder engagement can enhance the company’s reputation with shareholders. The challenge for directors is not whether to engage with shareholders but how to best harness the potential advantages that various forms of shareholder engagement have to offer ■

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