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On the board's agenda | September 2015

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Shareholder engagement

Proactive engagement: Opportunity to build stronger relationships

Companies today are seeking greater engagement with their shareholders in response to increasing activism among shareholders, legislation in the US and other jurisdictions giving shareholders a greater voice in companies' activities (such as "say on pay"), quasi-regulatory initiatives like the European Union's Shareholder Rights Directive, and many other factors.

> Good engagement practices provide the board with valuable feedback about shareholders' priorities and concerns.

Shareholders need information that enables them to understand an organization's governance policies, performance, business objectives, and key risks. While some of that information is provided in a company's regulatory disclosures, those disclosures rarely satisfy most shareholders' needs. A recent survey of 290 investment professionals by the CFA Society of the UK found that 60 percent of respondents believe financial reports contain too much irrelevant information, while at the same time 55 percent stated that financial reports also omit important information.[1]

Proactively engaging shareholders to better ensure they have the information they need helps companies strengthen their relations with shareholders by building trust and credibility, which can be of significant value to the company in the event of a hostile acquisition attempt or other crisis as well as during normal business conditions.

1 CFA Society United Kingdom, CFA UK annual survey on Financial Reporting and Analysis, 2015

Good engagement practices also provide the board with valuable feedback about shareholders' priorities and concerns.

Traditionally, the board has been responsible for approving the company's communications and/or disclosure policy, while delegating its implementation to management. Boards should look at where management has positioned shareholder communications on a continuum between reactive or passive compliance-based communications on one end, and proactive shareholder engagement at the other. The board will want to be satisfied with where management has positioned the company's communications, and that the company's key shareholders also agree with that positioning.

Management, through the company's Investor Relations (IR) function, has traditionally provided "education" for shareholders on the company's performance, operating results, long-term strategies, principal business risks, competitive positioning, and other matters. However, the IR function might not be as well positioned to engage with shareholders on governance issues. Some companies have implemented a governance function, often through the corporate secretary or general counsel, to lead engagement on governance matters, and increasingly boards are taking a heightened role in directly engaging shareholders, especially around topics such as executive compensation and board composition.

With the responsibility for shareholder engagement shared among different groups, it is important that these groups' activities be coordinated and supportive of each other so shareholders don't receive inconsistent or contradictory information about the company. Accordingly, boards may wish to create a shareholder engagement policy that provides a framework for topics appropriate for discussion with shareholders (and those that are not), identifies who within the company should engage shareholders on a given topic, and sets out a process for addressing specific concerns.

As more companies expand their outreach to shareholders, there is some concern that investors' bandwidth may become overloaded. If so, companies will need to be increasingly innovative to ensure their messages get through. Timing and persistence is also essential for a successful engagement program.

Companies that take a reactive approach to shareholder engagement—reaching out to shareholders only when a critical shareholder proposal or other issue arises—may not be successful in engaging their shareholders when they need their support. Companies, therefore, should view shareholder engagement as a proactive, ongoing activity to be maintained particularly outside the annual meeting season so that shareholders will have more time to engage and respond to companies' requests, and there is time to build mutual trust and respect.

Timing and persistence is essential for a successful engagement program

Boards that choose to engage directly with shareholders on governance issues may need to provide directors with additional education on corporate governance and related topics so they clearly understand the company's position and can speak knowledgeably about it. Directors may also need public speaking training and be sure they understand legal concerns, such as SEC Regulation FD in the US and similar rules in other jurisdictions that are designed to prohibit the selective disclosure of material information.

Deb DeHaas
National Managing Partner, US Center for Corporate Governance, Deloitte LLP

"Companies are increasingly focused on engagement strategies, viewing engagement as an opportunity both to inform and educate shareholders as well as to get feedback from them. As a result, companies need to think about which shareholders they target for engagement and how to engage with them—for example, should the company engage with just institutional investors, and if so, how many? What's the right way to engage with retail investors, who are generally more supportive of management and the board? Should members of the board engage with shareholders and, if so, under what circumstances?

"Companies should also look for opportunities for innovative approaches to engaging shareholders. For example, how can the Investor Relations function be used as a mechanism for engagement? Can communications to other key stakeholders be used to facilitate or support engagement with shareholders? These and other considerations should lead to engagement that is more robust and more fruitful to companies and investors alike."
Deb DeHaas, National Managing Partner, US Center for Corporate Governance, Deloitte LLP

A governance advisor's perspective

Abe Friedman is the founder and managing partner of CamberView Partners. With over a decade of experience in governance matters, Mr. Friedman advises boards and management teams of public companies on how to succeed with their investors in the context of shareholder activism and engagement. The opinions expressed here are those of Mr. Friedman.

Are we seeing a new era in company-investor relations?

We are living through a fundamental shift in the way in which investors interact with companies and boards. There has long been a demand from investors for engagement. Companies historically have not invested in understanding the part of the investor community that makes voting decisions. Today's investor landscape is increasingly complex, with investors leaning in to the voting of critical issues around directors, activism, corporate governance, and compensation matters. In this environment, companies are finding that it has become important to better understand how investors view them and what their expectations are if they are to stay ahead of potential challenges and deliver in a way that is well received and supported by their shareholders.

Who should companies engage with and what should they expect?

Companies can't talk to every one of their investors so they should look through their investor roster to identify those with the most meaningful impact in the shareholder base and the key influencers—the people whose voices resonate in the investor community—who can give them insights into the broader thinking in the investor community. These are also the people who, if the company engages effectively with them, will be a conduit to getting the company's messages out in a positive light. Importantly, in many institutions, these key contacts are not the portfolio managers and analysts with whom companies frequently interact. Instead, members of senior leadership or proxy committees and governance analysts may be the core audience for engagement.

When it comes to what companies should expect from engagement, it won't be anything as specific as a to-do list. Investors aren't monolithic; they all have different horizons and different objectives. Instead, engagement is a process to get input to help keep the company attuned to what their investors think in a broader way, and specifically about what certain investors think about the company's strategy, the performance of the business, and its governance and the board, among other things. It's then up to the board and management to factor that input into the decisions they make going forward.

For their part, what do investors expect from engagement?

Investors know that the board and management have information and knowledge about the company that they do not. They're generally willing to let management run the company and to let the board exercise oversight. What they want is to provide input and have their voices heard. That doesn't mean they expect that management and the board will do everything they ask, but they do want to understand the reasons behind the choices that the company does make. Ultimately, investors are looking for companies to listen to them and respond in a way that builds long-term value.

How and when should companies engage with their investors?

Companies should be proactive about engagement. They can't wait until there is a problem before they meet with their investors and the people who vote their shares. They also need to do their homework and understand what investors are thinking and what's behind the investors' policy, proxy voting guidelines, and approach to the issues that are relevant to that company.

Large institutional investors hold thousands of companies and, while the voters at those institutions want to engage, they don't have time to meet with every company multiple times a year. Companies, therefore, need to use the time they have with investors effectively and thoughtfully.

The best time to meet with investors is outside proxy season. That's when the company should talk with them about what's happening with the company and share information about strategy, operations, future direction, governance and the roles of the board and management, and how the company is protecting the long-term interests of its investors. It's also important to cover the matters of concern to investors, such as executive pay and proxy access.

If the company is effective in doing that, then, during proxy season or when a shareholder meeting is coming up, the company only needs to reach out to offer to respond to any immediate questions investors may have.

Who should engage investors around governance issues?
I don't think there is a best practice; from what I've seen, it varies from company to company. We have clients where the head of investor relations (IR) is very effective and is the best person to lead the engagement. With other clients, it's the chief governance officer or corporate secretary. Sometimes the CEO or CFO wants to be more directly involved, and there are companies where directors want to be part of the engagement process. So, the job title of the person leading the engagement is not usually what is important; what is more important is that the individual is well prepared to discuss the matters investors care about and has a good understanding of the audience.

On the subject of board engagement and where that is heading, I do believe boards are going to be more engaged with investors on some governance matters going forward. At the same time, it's important for management to develop their relationships in addition to those of the board, because "in all likelihood" the communication between investors and the company will continue to be owned primarily by management. Board members will be helpful and effective in certain contexts, such as around board leadership, corporate governance, and executive compensation, but to be most successful companies need an open line of communication between investors and a designated individual who is part of the leadership team.

What do companies do a good job at communicating?
The answer to this question is, again, something that is very company specific. In general, companies are good at communicating their financials; most companies have a well established IR function and they do a good job in that area.

Where companies are still getting their "sea legs" is around strategy and governance issues. Historically, they have not really engaged with investors on these issues; voters at big institutional investors tend to think about these issues very differently compared to a traditional portfolio manager.

Furthermore, most companies haven't had a lot of exposure to the voters at their large institutional investors, so many of them are still on a learning curve in this area. We're in an era now, however, where companies really do need to understand the new dynamic, and if they want to stay ahead of the issues, then they need to be more savvy about how they engage, and come with a better understanding of what is important to investors. I think many companies are trying to do that.

What is the most important thing about engagement?
The most important thing, by far, is being prepared and understanding who the people are that you're going to talk to and how they think about the issues to be discussed.

For years, I sat on the other side of the table from companies when I voted shares at the largest investment managers in the world, and the people I met with didn't really know who the people on my team were, what was important to our firm, or how we thought about the issues we were discussing. At that time, most companies didn't feel they needed to invest much in engagement—primarily because we did not make the buy and sell decisions that have been historically viewed as the key role for investors—and we often ended up talking past each other. With that attitude, a lot of companies would have been better off not meeting with us at all, because the impression they created was much worse than what I would have assumed in a vacuum.

In today's environment, where voting is much more important and where the corporate governance function in big institutions is much more relevant and critical to how companies make decisions on very important matters, companies need to make the effort to clearly understand who the people are that invest in their company and vote their shares, and ultimately, what really matters to them.

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Acknowledgements

The Deloitte Global Center for Corporate Governance would like to thank all of its professionals who assisted with drafting, editing, and reviewing this alert, including those listed below:

Co-authors: Chantal Rassart (Deloitte LLP) and Hugh Miller (Hugh Miller Communications).

Technical reviewers from our various Centers for Corporate Governance: Robert Lamm, Michael Rossen, Kevin Tracey, and Gillian Wyett.

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