Shareholder Engagement Trends and Considerations

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Shareholder engagement continues to be an important consideration for companies in communicating their long-term strategy and deepening relationships with their investors, and boards are becoming ever more involved in the process.

In PwC's 2019 "Annual Corporate Directors Survey," 51% of the directors reported that a member of their board, apart from the CEO, engaged directly with a shareholder in the past year.[1] One third of more than 300 directors, senior executives and legal advisors surveyed by KPMG in June 2019 reported more significant board engagement with shareholders over the last two to three years than in the past.[2] Not only has director engagement increased, but directors have also reported "a positive impact on shareholders' voting and investing decisions" as a result.[3]

Below, we discuss the latest trends in shareholder engagement and considerations for companies and their board members in crafting and executing an effective strategy for communicating with investors and other constituents, both during proxy season and in the off-season.

Communication Trends

Communication with investors no longer takes place solely within the bounds of the proxy season. Investors and companies alike benefit from year-round communication. In Morrow Sodali's 2019 "Institutional Investor Survey," 87% of respondents indicated that "proactive and regular engagement with the board of directors" assists them in evaluating a company's culture, purpose and reputational risk. Companies are increasingly

[1] PwC 2019 Annual Corporate Directors Survey.

[2] Stephen L. Brown, "What is Your Company's Engagement Strategy?" *NACD Directorship* (September/October 2019), available here.

[3] PwC 2019 Annual Corporate Directors Survey.

engaging with shareholders during the quieter off-season in one-on-one "sunny day" meetings, which allow companies to establish a foundation for communications with shareholders and increase the likelihood of shareholder support when there is a contested situation such as an aggressive shareholder proposal or proxy contest.

In 2019, shareholder proposals were withdrawn at higher rates than in prior years, indicating productive engagements between companies and investors. Approximately 46% of environmental and social proposals filed in 2019 were withdrawn, compared to prior seasons' lower withdrawal rates of 35%-40%.[4]

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After successful engagement with shareholders, several companies committed to increase and improve disclosure on topics such as sustainability, social responsibility, diversity and political spending. Some companies committed to consider more diverse candidates for board member and executive officer positions and agreed to set renewable energy targets.

For example, Trillium Asset Management submitted many proposals to companies requesting reports on diversity of the executive leadership teams and eventually withdrew such proposals at various of the companies, following successful engagement that resulted in commitments to strengthen public disclosures related to workforce diversity and inclusion or to provide such information in a report. This positive trend indicates that shareholders and companies are communicating more effectively and more often, and that companies and boards can benefit from continuing to improve their engagement process.

Large institutional investors are more focused on financial and strategic matters in engagement. As noted in BlackRock's 2019 "Investment Stewardship Annual Report," BlackRock expects that boards "should be fully engaged with management on the development and implementation of the company's long-term strategy."[5] Approximately 46% of BlackRock's engagements in 2019 touched upon long-term corporate strategy, and one-third of such engagements included multiple meetings with the same company on strategy. Institutional investors are not only focused on companies identifying and implementing a corporate strategy but also expect the board to oversee such implementation and be able and willing to engage with investors on the company's strategy.

Similarly, Vanguard assesses the board's understanding of a company's strategy and ability to identify and govern material risks. Overall the trend is toward increased scrutiny from investors on board composition and directors' experience, expertise and ability to understand the company and its strategy for creating long-term value. Investors also indicated that independence and the skills of directors are critical in evaluating individual board members.[6]

Another trend that remains at the forefront of investor concerns is disclosure. Shareholders are not simply requesting additional information but also are focusing on the quality of disclosure, in particular with respect to certain topics such as human capital management and climate change.[7] Investors would like to see more detailed disclosure when a factor is material to a company's business, such as a discussion of fair

[4] ISS US Environmental and Social Shareholder Proposals 2019 Proxy Season Review.

[5] BlackRock 2019 Investment Stewardship Annual Report.

[6] Morrow Sodali Institutional Investor Survey 2019.

[7] Morrow Sodali Institutional Investor Survey 2019.

labor practices for an apparel company.[8] As investors become more sophisticated, companies and boards must strategically prepare and respond to these types of investor concerns.

Considerations for the 2020 Proxy Season

In preparation for the 2020 proxy season and engagement with shareholders, companies and boards should consider the following in developing a strategy for engaging with shareholders and communicating with other stakeholders.

Strategize on a Long-Term Plan for the Company

— Be informed and aligned with management in developing the company's long-term strategic vision. The board should revisit the long-term plan for the company annually.

— Ensure there is consistent messaging among all constituencies (e.g., investors, employees and customers). A unified and consistent message with robust shareholder communication builds support for the company's long-term plan.

— Be specific in identifying a corporate purpose and culture and demonstrating how it informs the company's plans for growth and financial performance.

Know Your Investors

— Identify the company's largest shareholders and key stakeholders.

— Review the investors' published guidelines, policies, statements, voting history and involvement in campaigns for shareholder proposals, governance initiatives or activism.

Review and Revise Disclosure

— Include voluntary disclosure regarding current engagement with shareholders, feedback received from shareholders and how the company responded. Many companies are providing this information in their proxy statements in the summary, corporate governance and executive compensation sections.

— Provide more granular disclosure specific to the company, its business and its risks.

— Take investor concerns into consideration when creating and updating public information, including disclosure, presentations, websites, CSR reports and other public forums, including social media.

— Ensure that the board, management and others throughout the company coordinate to maintain current and consistent disclosure and communication with investors and other stakeholders.

Focus on Key Topics

— Focus on how ESG topics relate to sustainability and the company's long-term plan.

— Consider adding disclosure and reporting on key concerns for investors such as human capital management and climate change, after determining which metrics and ratings are relevant to the company.

— Highlight steps the company is taking to ensure value creation is not impeded by adverse impacts arising from neglect of ESG issues.

[8] Morrow Sodali Institutional Investor Survey 2019.

— Consider linking executive compensation practices to strategy and performance, including financial, operational and increasingly sustainability measures.

— Address topics about which there are misunderstandings or controversies (whether raised by analysts, media or activists, or conveyed privately to the company).

— Benchmark governance and other practices against similarly situated issuers, including competitors, others in the sector or index and others in a specific investor's portfolio.

Consider Process for Engagement

— Determine who will be authorized to engage directly with investors:

- Management participants almost always include the head of IR and may include the CFO, the GC or corporate secretary to discuss governance items; the CEO if there are controversies in the market relating to strategic direction; and, in some cases, the heads of specific business units of interest.

- Many engagements involve a non-management director (the board chair or lead independent director and compensation committee chair often engage with investors).

- Many large institutional investors expect to be able to engage with a director.

— Timing of shareholder engagement is a crucial consideration. The proxy season is often the busiest time of the year for many institutional investors, so consider communicating with investors during the off-season and conduct so-called "sunny day" engagements during the late summer or early fall, which is typically the least busy time for most institutional investors:

- *Format*. Be flexible on whether to hold telephonic or in-person meetings.

- *Information in the Meeting Request*. Propose a list of topics and attendees and highlight recent developments that the company wants to discuss.

- *Whom to See*. Top 20 shareholders and additional smaller institutional holders.

— Consider engaging third-party firms to provide services: 26% of companies polled in PwC's 2019 "Annual Corporate Directors Survey" engaged a third party to advise the board on potential activism, and 26% used a stock-monitoring service to receive regular updates on ownership changes.[9]

[9] PwC 2019 Annual Corporate Directors Survey.