Shareholder engagement: An evolving landscape

The best defence is a strong offence – preparing for and engaging constructively with activists is the route to corporate success.
The significant rise of activism over the last decade has sharpened the focus on shareholder engagement in boardrooms and executive suites across the US.

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 overall.

When active shareholder engagement works, it leads to a productive dialogue with the investors, the governance departments established by the big institutional firms, which typically oversee proxy voting. It is important to remember the reality of public company ownership. The vast majority of public companies have shareholder bases dominated by a diverse set of large, institutional funds. Engagement with these voters not only helps head off potential problems and activists down the road, but it also gives management valuable insight into how patient and supportive their shareholder base is willing to be as they implement strategies designed to generate long-term growth. Indeed, the rising level of engagement is a positive trend that could, over time, help mitigate the threat of activism if properly managed.

This all sounds encouraging in theory and, in some cases, it works in practice as well. But the simple fact remains that this kind of dialogue is unobtainable for the vast majority of public companies, despite the best of intentions on both sides.

Struggles with engagement

Even the largest institutional investors, many of whom are voting well in excess of 10,000 proxies a year, have at most 25-30 people in their governance departments able to engage directly with companies. Those teams do yeoman’s work to meet demands, taking several hundred and in some cases well more than 1,000 meetings with company executives or board members a year. But with more issues on corporate ballots than ever before that need to be researched and analysed, companies are finding it increasingly hard to get an audience with proxy voters even when a determination is made to more proactively engage. This can be true for even large companies with market capitalisations in the billions.

Indeed, for small-cap companies, the idea is almost always a non-starter, though there are workarounds. Some institutional funds are willing to use roundtable discussions with several issuers at once to cover macro topics. Most mid-cap companies are out of luck as well, unless they are able to make a compelling case around a particular issue that catches a governance committee’s eye (more on that in a minute). Large-cap companies certainly meet the size threshold, but even they need to be smart in making the request. The net result is a conundrum at companies that are willing to engage but find their institutional investors less willing to do so, or are stretched too thin to make it happen.

The problem is a difficult one to solve. In today’s environment, companies cannot wait for a pressing issue to engage with their shareholders. By the time the issue becomes public because an activist has shown up or some other concern has emerged that affects the stock, it is often too late to have a productive conversation. Investors in those situations must decide what they know or can learn in a condensed period; they have little ability to become invested in the long-term thinking behind, for instance, a company’s change to executive pay or corporate governance. At the same time, institutional investors, while very open to and, in many cases, strong advocates for meeting with executives, cannot always handle the number of requests they receive, particularly when the requests come in during a condensed period. This has led some investors to establish requirements around which companies ‘qualify’ for a meeting, leaving some executives that don’t meet the thresholds frustrated that they can’t get an audience. Both sides are striving to improve the process in this rapidly evolving dynamic. The fact is that both sides have a lot of room for improvement.

Here are a few guidelines we advise companies to use when deciding how or even if they should more proactively engage with their largest investors.

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In many cases, it involves input from the portfolio manager, internal analyst and the governance department, as well as perhaps some influence from proxy advisory firms, such as ISS or Glass Lewis. But the ultimate decision-maker is always somewhere in that mix. The trick is to find out where. Start with the contacts you know best, but don’t settle for one relationship. If you don’t know your portfolio manager and governance analyst, then you are not going to get a complete picture on where you stand. In many cases, the PM can be a helpful advocate in having a governance analyst understand why certain results or decisions make sense. Once you find the right mix of people, selling the story will be much easier.

Don’t assume passive investors are passive

Today, many so-called passive investors are anything but. One passive investor told me his firm held more than 200 meetings with corporations last year.

A governance head at another institution said there is little difference today in how the firm evaluated proxy questions between its active and passive holdings. You may not always get an audience, but on important matters, treat your passive investors like anyone else. You may be surprised at how active they are. These firms also tend to be the busiest, so be assertive and creative in building a relationship. The front door may not be the only option.

Choose the best messenger

There is an interesting debate going on in the governance community right now about how involved CEOs and board members should be in shareholder discussions. As a rule, we view it this way: routine conversations around results and performance can be handled by investor relations (IR). More sophisticated financial questions get elevated to CFOs. Once the conversations delve into strategy and growth plans, CEOs should be involved, but usually only with the largest current or potential shareholders. And, finally, when it comes to matters of governance policy, consider having a board member involved.

Board engagement with shareholders is a relatively new trend, but an important one. Investors are often reassured when they see and hear from an engaged board and many will confess that those meetings can change their thinking. But having the right board member who can handle those conversations and be credible is key. A former CEO, who is used to shareholder interactions, or a savvy lead independent director can fit the bill. But with investors increasingly asking for – and indeed many boards starting to offer – meetings with directors, every board should be evaluating who that representative will be if the opportunity comes along.

Be prepared and walk in with a clear set of goals

Too often, companies spend too much time just trying to determine what not to say in meetings with investors and not nearly 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 story. 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. Be upfront and honest about why you are requesting the meeting. Governance investors are far more engaged when companies walk in with stated goals in mind. Surface potential problems and your solution to them, before they emerge.

Making the effort

Even with this level of planning, large companies can still find their requests for engagement on governance topics unheeded. Many of the large, institutional investors have installed various thresholds, generally predicated to a company’s size, that companies need to meet to receive an audience. But that does not mean companies should give up. Continue to work the contacts you do have within each institution. Tell your best story in routine discussions, such as earnings calls or conference presentations. Those are too often missed opportunities. Look for other opportunities to get in front of investors.

Conferences can be great forums, as can organisations, such as the Society of Corporate Governance, Council for Institutional Investors or National Association of Corporate Directors. Every time you communicate externally, it is a chance to tell your story and make the right disclosures. History is littered with companies that waited too long to do so, came under attack and lost control of their own destiny. Don’t waste any opportunity to make your best case to whomever is listening.