- Dodd-Frank has led to trend for greater shareholder engagement
- Governance roadshows provide one effective approach
- Talk to institutional investors and proxy firms in September and October
- Companies should be careful not to over-engage

By Nicholas Rummell

Engagement strategies that can help you win

Talk to your shareholders or face their wrath – that's the lesson many companies have learned over the last two years as shareholder fervor over executive compensation has continued to grab headlines. Many companies have made rapid efforts to improve their written disclosure, telling their story about contentious topics like executive compensation through supplemental proxy filings riddled with colorful graphics. But shareholder engagement has become more than just turning compliance documents into communication tools. It now requires a greater human element, as many issuers are finding out – some the hard way.

Many believe the trend toward greater shareholder engagement was set in motion after the Dodd-Frank legislation was passed and say-on-pay regulations were mandated. A 2011 study of 161 institutional investors and 335 issuers commissioned by ISS found that 50 percent of issuers and 64 percent of asset managers were engaging with shareholders more, and almost none said they were decreasing their engagement. A year later, while some companies had begun engaging shareholders on a greater level, others were still skirting the issue. A December 2012 study by Deloitte found that more than 50 percent of large-cap and small-cap public companies surveyed had interacted directly with shareholders – but only 27 percent of mid-cap firms had carried out such shareholder interactions.

In January a study commissioned by the Conference Board suggested that shareholder engagement efforts will need to ramp up even more this proxy season. The study found companies that performed worse in their say-on-pay votes in 2011 made an extra effort to engage with shareholders the following proxy season. Some of those companies revisited their compensation policies, while others were able to pacify investors by explaining their pay rationale better, says Matteo Tonello, managing director for corporate leadership at the Conference Board. 'In both types of cases, communication with shareholders played an important role,' he says.

The CalPERS effect

But Tonello also suggests that the boost in engagement might be directly related to the headlines that say-on-pay votes garner. 'When national newspapers publish on their front page a list of firms that have failed a [say-on-pay] vote, those firms have no choice but to develop an investor communication plan,' he explains. 'In a few years, when the news no longer makes the headlines in the same media outlets, the reaction may be different.'

Despite this so-called 'CalPERS effect' – wherein issuers' hands are forced by unwanted attention from activist shareholders – many experts say increased shareholder engagement is here to stay. And, they argue, the CalPERS effect may be growing. Companies that failed say-on-pay votes in 2012 had received more than 90 percent support on similar proposals during the previous proxy season, says John O'Grady, senior vice president at Laurel Hill Advisory Group. 'It's a moving target,' he states. 'The landscape hasn't really settled down.'

The landscape for engagement best practices hasn't really settled either, but there are a few options, one of which is a governance roadshow. 'We're seeing more and more companies setting up and pursuing dedicated governance roadshows instead of just investor roadshows,' says Lucas Scheer, president of LS Global Advisory Group, which helps organize such meetings. 'Proxy votes are never assured, but you won't know whether a vote will come your way if you meet with just the investor; you want to meet with the proxy officer.'

Ideally, experts say, a roadshow should be held in the months before the annual meeting, but not too far ahead, in order to get the most accurate information possible. The roadshow team should consist of the corporate secretary, investor relations managers and human resources executives. For your bigger investors, you might want to also send the CFO, Scheer says. 'You should try to pursue a schedule of meetings with investors by city. If you're meeting with [the governance contact at] a top institutional investor, you can meet with the investment contact there as well.'


Lucas Scheer

Governance roadies

But should board members also become governance roadies? 'Absolutely they should,' says Charles Elson, who heads up the John L Weinberg Center for Corporate Governance and sits on the HealthSouth board. 'For a director to effectively monitor management, he or she needs to listen to all sides. It helps you be a better director.'

A lead director or chair of the compensation committee could be an invaluable member of a roadshow, especially if a large investor wants to talk to a member of the board. 'It depends on whether the company is putting a really contentious proposal up for a vote,' Scheer says. 'Routine proposals wouldn't be worth the investor's time. You don't need a director unless he or she is a key individual for a specific proxy proposal.'

Before hitting the road, companies should do their research and determine exactly what the sticky issues are. Proxy solicitation firms often conduct voting-predictive analyses to determine how institutional investors, such as mutual funds and pension funds, are likely to vote on specific proxy proposals. You need to know which issues your key shareholders are most interested in.

'If you have a history of corporate governance-related issues, or you think there will be an issue that will come up, you should be engaging throughout the year,' recommends Brad Robinson, managing director of Eagle Rock Proxy Advisors. He suggests talking with shareholders in the off-season, usually late summer or early fall, when they have more time to devote to such meetings. 'You want to avoid surprises before the annual meeting,' he adds.

Companies like BP and Jacobs Engineering have been lauded for their successes with one-on-one shareholder meetings, turning around shareholder opposition to compensation and corporate governance within a year. Even the AFL-CIO, which has been a corporate scourge in recent proxy seasons, has said it withdraws more than half its proposals following satisfactory engagement.

Engagement shouldn't be limited to shareholders, however. Companies with noted governance issues or that have received weak governance ratings from Glass Lewis or ISS should consider a formal sit-down with one or both proxy advisory firms, too. Both Glass Lewis and ISS have thresholds for when they believe companies should engage more with shareholders: For Glass Lewis it's when there's 25 percent shareholder opposition on a proxy vote; for ISS, it's 30 percent.

Some say, however, that even 10 percent opposition is potentially troubling. 'If you wait until you really need to talk to somebody for first contact, it may already be too late,' notes O'Grady.

Other strategies

Smaller companies can pursue cheaper and quicker options, such as holding a so-called fifth analyst call – essentially an open forum for shareholders to ask questions outside of the four regularly scheduled analyst calls. Such calls were promoted in 2011 by UK investors including Railpen Investments and F&C Asset Management, but have since failed to gain any serious traction with companies.

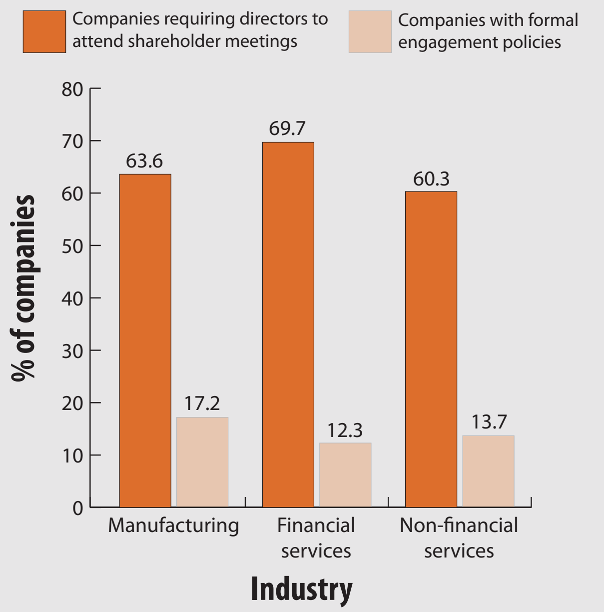
Only five firms, all large caps, conducted such calls in 2012, according to a Deloitte study; no companies surveyed in the Corporate Board's recent study used them. Part of the problem is that the strategy is a misnomer. 'You are talking to a different audience when you are doing analyst calls,' says John Borneman, a principal at consulting firm Semler Brossy. 'The analyst is not voting the proxy. It is a governance group.'

Another tactic rarely used – but inching onto companies' radars – is social media. Facebook and Twitter have become huge tools for consumer outreach and may indeed become important for conducting shareholder outreach, Robinson says. 'They are public, though, so you really have to be careful what you say,' he cautions. 'Smaller companies might not want to venture there because of potential missteps. You don't want to be too early an adopter.'

It's also possible to encourage investors to come to you. Take Prudential, for example, which publicizes its top governance official's contact information on its website and welcomes investor comments, forwarding appropriate shareholder feedback to its board. The firm even has a portal for investors to comment specifically on executive compensation.

AST Phoenix Advisors suggests that issuers proactively engage ISS, Glass Lewis and institutional investors in September and October to try to get ahead of potential problems by obtaining feedback on what drives specific shareholders' voting decisions. In a client update, AST Phoenix explains: 'Armed with this intelligence and feedback on investor preferences, management and the board will then have time in the late fall to consider and make any appropriate changes to their company's compensation and corporate governance practices as well as their disclosure in advance of the upcoming proxy season.'

WHO'S MORE ENGAGING?



Source: The Conference Board and NASDAQ/NYSE Euronext

Staying on message

Of course, there is also the risk of doing too much shareholder engagement. Executives can be off-message or lose focus during meetings, or give away the store to one investor while not relating the same information to others, thereby running afoul of Regulation Fair Disclosure. 'You don't want to go into the market and appear disjointed or confused in your message,' O'Grady warns.

After the first occurrence of a fifth analyst call, by Occidental Petroleum in 2011, some cried foul, complaining that the call was less than two days before Occidental's first-quarter earnings report and that the company's stock closed 2.5 percent higher the day of the call. Ultimately the company was not found to have violated any securities rules, but that type of scrutiny is making any company considering the governance measure decidedly skittish.

It's a fine line to tread, not giving away too much information while also satisfying demanding shareholders. 'These proposals have to be talked about in a way that is general enough to justify the reasons why a proposal would be needed or important without giving too much detail and saying, *This will be on our proxy next year*,' Scheer points out.

Shareholders who are focused only on the bottom line may also be turned off by firms that come across as being too accessible at the cost of doing business. 'Management should be running the company,' Robinson says. 'You don't want a constant stream of information between shareholders and management. Overall strategic info can be communicated with dialogue, but not implementation. There's a real line to be drawn where it gets in the way of efficiency.' CS

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