INSIGHT SERIES

Direct-To-Shareholder Communication: Managing the New Normal in Investor Relations

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The past few years have seen shareholders become increasingly vocal in their desire to communicate directly with a company's board of directors. Rather than being limited to conversations with management and investor relations officers, shareholders want access to the individuals who serve as fiduciaries of their investments. As a result, director-to-shareholder communications have become a key element of any successful investor relations program.

Specifically, large passive money managers like BlackRock, State Street and Vanguard continue to stress the importance of engagement in describing how they hold their portfolio companies accountable. While "engagement" is a broad term, in this context it is generally taken to mean discussions regarding company policies and how a board's decisions are aligned with business goals.

Interestingly, *The Wall Street Journal* notes that BlackRock CEO Laurence Fink used the words "engage" or "engagement" 15 times in his most recent annual letter to CEOs(1). This repetition is certainly no accident. It is a stark reminder that while BlackRock prefers to engage constructively with companies, it will not hesitate to exercise its right to vote against management recommendations. BlackRock also committed to doubling the size of its governance team to enhance its ability to engage with the companies in its portfolios.

In examining the trend of director-to-shareholder communications, PwC's 2017 *Annual Corporate Directors Survey* found that 42% of the nearly 900 public company respondents reported that their non-CEO board members engaged with shareholders in 2016. It is reasonable to expect investor demand for greater levels of engagement to continue increasing. Consequently, companies must reevaluate the role directors play in ongoing shareholder engagement and establish a clear director-to-shareholder communication policy.

Companies should not wait for a shareholder to express a desire for director communication. Rather, management teams should broach this important topic with their directors and develop a point of view in advance. These conversations are critical to understanding the board's views on engagement and, more specifically, the topics it is comfortable addressing. While there is no single solution for how companies should best approach this emerging communication practice, proactively defining strategic issues from the board's perspective can build shareholder support and reduce the risk of shareholder dissension, and even activism.

As a best practice, all companies should reach out to the corporate governance teams at their largest shareholders—including passive funds—prior to proxy season. This shareholder engagement activity is viewed favorably by proxy advisory firms like Institutional Shareholder Services (ISS) and Glass Lewis, and this outreach should be documented in the issuer's proxy materials. Due to the volume of companies owned in passive funds, it can be difficult for portfolio managers to meet with everyone, making the need to engage outside of proxy season all the more important.

Developing an engagement strategy, including director-to-shareholder engagement, is even more critical for companies that received opposition from ISS or Glass Lewis on some aspect of their proxy in the prior year. If there were any proposals or director nominees put forth by the company that ISS or Glass Lewis recommended against or did not receive a healthy margin of shareholder support, management and the board must be prepared to address what, if any, changes are being made in response.

To maximize the outcome of director-to-shareholder engagement, consider the following best practices:

- **Identify which directors are best suited to communicate with shareholders.** This process should take into account personality types, receptivity to the exercise, subject matter expertise and communications prowess. Most importantly, there must be a common understanding and mutual agreement as to the desired outcome of the engagement. In other words, everyone has to be on the same page.
- **Determine what topics are relevant and appropriate for director-shareholder discussion.** In addition to matters related to corporate governance, executive compensation and director nominations, consider what elements of the business strategy and operating environment can and should be addressed.
- **Take a team approach.** There is strength in numbers, and this is especially true when it comes to shareholder engagement. In addition to having a director speak with top shareholders, the engagement team should also include other members of the management team, investor relations team, or other subject-matter experts, depending on the topic of conversation.
- **Identify the preferred methods and channels for communication.** An in-person meeting, a conference call or scheduling a video conference are all viable methods of communication. However, the pros and cons associated with each option must be carefully considered. Whatever the method, all parties should be made aware of the forum in advance.
- **Have a clear agenda.** Having an agenda is critical to advancing a productive dialogue. It is important to take into consideration the nature of the meeting (e.g. did the company arrange it or did the shareholder request it?) and develop a series of talking points and rules of the road to guide the conversation. The talking points should be supported by facts and anecdotes to give weight to the company's desired narrative.
- **Schedule a prep session.** Each shareholder has different areas of interest and focus. In order for a director-to-shareholder engagement strategy to be effective, the engagement team should prepare for each meeting, including researching the key areas of focus and conducting a mock question and answer session. Preparation and practice will be key to a successful engagement program. It will also help mitigate the risk of accidentally disclosing material, non-public information.

Today, public companies are operating in an environment where institutional investors expect corporate boards to engage in conversations about the strategic direction of the enterprise. Therefore, it is incumbent upon directors to evolve their mindsets and overcome the desire to remain behind the scenes. While there are risks to consider when increasing board-to-shareholder communications, these potential risks should not paralyze efforts to improve shareholder engagement.

When done correctly, director-to-shareholder engagement can be mutually beneficial. Directors have the opportunity to hear unfiltered shareholder perspectives and learn more about their priorities. Conversely, investors can benefit from hearing first-hand the board's position and perspective related to business strategies and corporate governance matters. Over time, periodic director-to-shareholder interaction can help build trust on both sides.

(1) The Wall Street Journal – "At BlackRock, Vanguard and State Street, 'Engagement' Has Different Meanings." 01/20/18.
https://www.wsj.com/articles/at-blackrock-vanguard-and-state-street-engagement-has-different-meanings-1516449600