



December 2017

Director-shareholder engagement: getting it right

Increasingly, directors are engaging directly with shareholders. That process is not always easy and it is not always smooth.

When done right, director-shareholder engagement can pay dividends for both the investor and the company. We identify the key steps for directors—and investors—to get the most out of these exchanges.





Years ago, “shareholder engagement” was an earnings call led by the company’s CEO and CFO, or a meeting with the investor relations team. Any contact was handled by company management.

Today, the picture is quite different. In PwC’s *2017 Annual Corporate Directors Survey*, 42% of the nearly 900 public company directors who responded say that board members (other than the CEO) engaged directly with the company’s shareholders during the prior year.

Directors are most likely to discuss strategy and executive compensation when they connect with shareholders



Q: On which of the following topics did a member of your board (other than the CEO) engage in direct communications with shareholders? (Select all that apply)

Base: 349

Source: PwC, *2017 Annual Corporate Directors Survey*, October 2017.

1 Interview with Glenn Booraem, April 25, 2017; available at <https://www.linkedin.com/pulse/investor-priorities-proxy-season-paul-denicola>

“For companies who just don’t want their directors engaging, I would ask: if the directors don’t talk to the owners they serve and represent, then who does?”

Glenn Booraem, Investment Stewardship Officer, Vanguard Funds¹

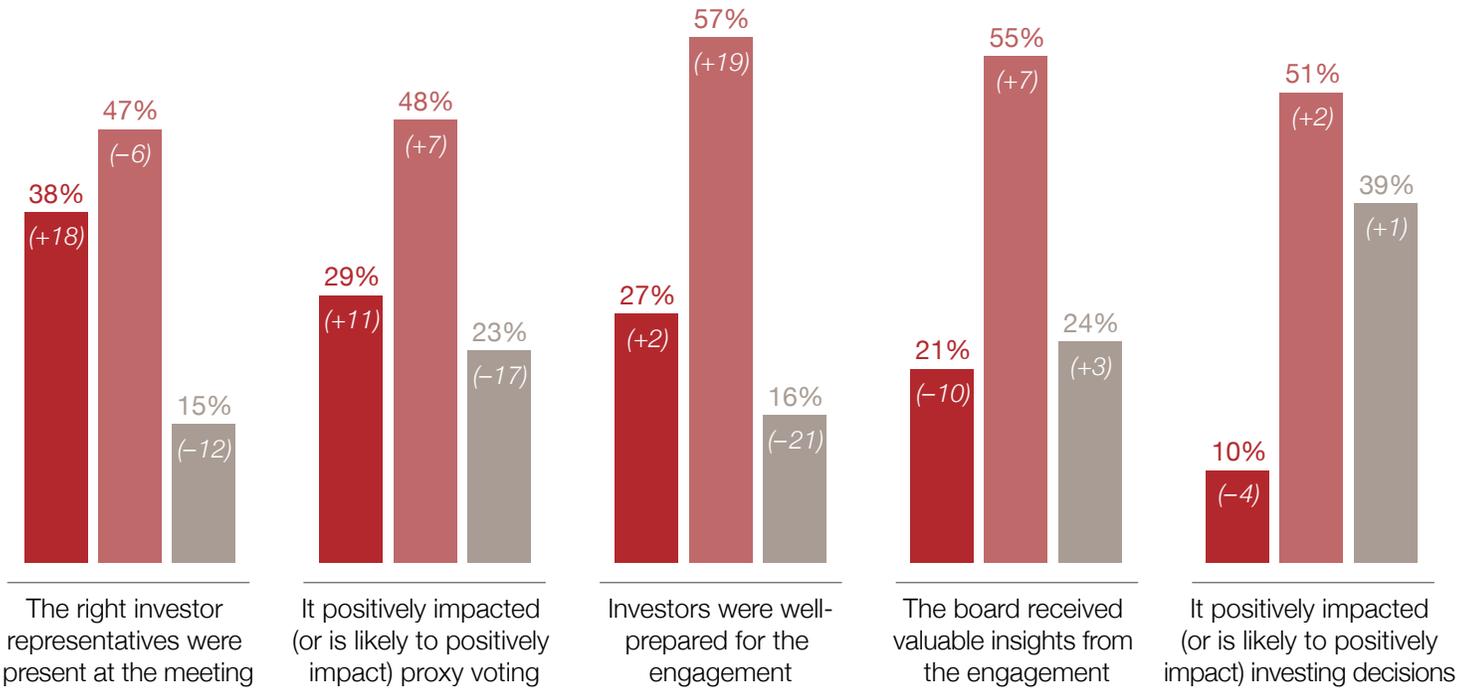
Engagement can be very beneficial—for both parties. Shareholders can express their concerns about the company and hear directors’ perspectives. They test out the rigor of the board’s oversight and gain insight into the company’s strategic plan. For their part, directors can learn about shareholders’ priorities and their concerns about the company.

Largely, it is about building a relationship. With that foundation in place, an investor may find that the company is more open to hearing its views and suggestions. From the company’s perspective, having the relationship in place could help if an activist investor comes along. Directors will already understand how key shareholders feel about company strategy, board composition, the management team and other issues. Essentially, a board with good shareholder relationships may be able to build up credit that it can draw on if times get tough.

Directors view engagements more positively than they used to. In 2017, the percentage of directors in our survey who at least somewhat agreed that investors were well prepared for meetings was up 21 percentage points (to 84%) from 2016. Directors were also much more likely to say that investors had the right people at the meetings. And that engagement positively impacts proxy voting.



Director views on engagement improving almost across the board



Q: To what extent do you agree with the following concerning your board's direct engagement with investors within the past 12 months?

Base: 316-335 (2017); 328-543 (2016)

Source: PwC, 2017 Annual Corporate Directors Survey, October 2017; PwC, 2016 Annual Corporate Directors Survey, October 2016.

Very much Somewhat Not at all

Note: Amounts shown in parentheses represent the change in percentage points from the 2016 survey

But anecdotally, both directors and investors still report some frustration with the process. Even with all the right intentions, the parties sometimes come away thinking that the engagement was a waste of time.

So how can investors, directors and management ensure their engagements are a success? Here, we outline three key steps for getting the most out of shareholder engagement. Our guidance applies whether these interactions are in-person meetings or done via conference calls or video chats.

Still avoiding shareholder engagement?

If your board isn't directly engaging with shareholders, we suggest you consider it. Even if your shareholders haven't made a request for engagement, management can ask if there's any interest as part of its regular investor outreach. If the demand is there, consider whether your board is comfortable and what topics might be on the table. If shareholders aren't interested, the simple fact that the company took a proactive approach on the topic may reflect well.



Step
1

Lay the groundwork

Focus on the proxy statement and company website

The foundation of shareholder engagement is the proxy statement. In the past, it was primarily viewed as a compliance document. Lawyers encouraged streamlined disclosures, and boilerplate language was the norm. Now, many companies see that it can also be a valuable communications tool.

If it's written well, the proxy can provide shareholders with more transparency and better insight into the company and the board. Such transparency can build greater trust. More companies are also clarifying and simplifying information. They're using executive summaries, graphics and tables. Some are even including answers to the frequently asked questions they get from investors in the executive summary. And they are taking the opportunity to highlight the good work the company is doing.

 **Tip for management:** *Take a fresh look at the proxy and look for ways to improve disclosure.*

Directors rarely have much involvement with proxy statements, even though the audit and compensation committees have to include reports that confirm they carried out specific responsibilities. Management drafts these reports, often using standard language, and then asks the committees to approve them.

By getting involved earlier in the process, directors may be able to encourage management to improve the proxy disclosure. Trends we are seeing include:

- Compensation committees are checking that the compensation discussion and analysis (CD&A) fully reflects their knowledge of the programs described. Directors on other committees are providing more of an outsider perspective on whether the disclosure makes sense.
- Audit committees are responding to pressure from investors for more information on how the committee oversees the external auditors.²
- Nominating and governance committees are pressing for better proxy descriptions in areas like board composition, board recruitment and board performance assessments.

But the proxy statement can't cover everything. The company's website can serve as an important resource for information that doesn't naturally fit into the proxy. This could include things like social or environmental initiatives at the company.

Clear and informative proxy disclosure makes shareholder meetings more efficient. Investors come with a well-defined picture of the board's key oversight processes and how the company's executive compensation plans operate. That saves directors from having to spend time clarifying basic information.

 **Tip for directors:** *Ask management how the proxy statement compares to expanded disclosures many other companies are making. Challenge management to consider more transparent and robust disclosure.*

 **Tip for management:** *Regularly update the company's website with relevant information and ensure that it is easy to navigate.*

2 See the Center for Audit Quality's *Audit Committee Transparency Barometer 2017*.



 **Tip for investors:** *Provide feedback during engagement sessions about the quality of the company's proxy disclosure. That might prompt companies to take a fresh look at their disclosures and get away from boilerplate wording.*

Time the engagement properly

For companies, shareholder engagement is likely to be top of mind during the one or two months before the annual shareholders' meeting. Management wants to avoid surprises on key votes. That can mean talking to shareholders about their concerns.

Most companies hold their annual meetings in the late spring. Since institutional investors are responsible for voting shares at thousands of companies, they are extremely busy just at the time engagement requests from companies start flooding in. So it's not a great time to try to build relationships. And generally shareholders will have to decline engagement requests unless there's a "crisis" of some sort—like a proxy contest.

Instead, the most effective shareholder engagement ideally occurs during a calm time, outside of proxy season. Directors and investors can get to know one another and build trust. This gives shareholders more time to think about the company's specific issues, and gives directors the chance to explain the company's strategy and perspective. If the first conversation comes instead when the company faces a "crisis" (such as an activist threat), shareholders may be more skeptical about the outreach. And a director's message could be inherently less credible.

Sometimes, engagement isn't needed. The company may make the offer to investors and find that they aren't interested in meeting with directors. Shareholders don't have the time to meet with every company in their portfolio. But even if they decline the offer, they'll usually make note of it, and that alone can benefit shareholder relations.

 **Tip for investors:** *Open up your calendar for off-season meetings. Consider rotating smaller companies into your engagement calendar every few years.*

 **Tip for management:** *Some investors, even if they don't think engagement is needed, will give the company "credit" for reaching out and offering.*

Looking beyond the largest shareholders

Many companies reach out every year to their largest institutional investors. They might define that as investors holding at least a 5% stake, or the top 10 or 20 investors. These investors are important, but companies may be overlooking other key shareholders. For example, pension funds may not be among the company's biggest shareholders, but they are corporate governance thought leaders who are often willing to engage proactively with companies. They are also among the most likely to submit shareholder proposals, and to collaborate with other shareholders who are seeking changes at the company. So engaging with them can pay dividends down the road.



Prepare properly for the meeting

Do your research

Investors and directors alike tell us that meetings work best when everyone prepares.

First, agree on an agenda. When both parties know which topics are on—and off—the table, each can prepare appropriately.

Once the agenda's confirmed, management can send relevant materials to the shareholder in advance. Summaries of board makeup, company strategy or executive compensation can help, as long as they don't end up disclosing material nonpublic information. Shareholders can use those resources and their own research to update their knowledge about the company, its governance policies and the directors who'll attend.

Management and the directors involved will do their own homework, first by understanding the investor's stock holdings (including whether they're indexed), its views on governance issues and how it uses proxy advisory firms. The directors can also beef up their understanding of the board's decisions on relevant matters so they'll be able to explain them clearly in the meeting.

 **Tip for directors, management and investors:** Collaborate on the agenda and prepare thoroughly and thoughtfully.

 **Tip for management:** Send summary materials in advance.

Invite the right participants

A successful meeting requires gathering the right people. From the company's perspective, the agenda drives which directors will attend. If the matter to discuss is executive compensation, for example, it'll be the compensation committee chair. If the subject is board composition, the nominating and governance committee chair or lead director will attend. In some cases, more than one director may end up participating.

That said, the fact is that not all directors are equally adept at communicating. So pick a director who is "camera ready." Often that can mean someone who was (or is) a CEO or CFO. They have experience addressing investors and analysts, and a good sense of what to say and how—and perhaps more importantly, what not to say. Any director engaging with shareholders needs to be diligent about avoiding disclosure of material nonpublic information that would violate Regulation Fair Disclosure. No company—and no investor—wants to create a Reg FD problem.

 **Tip for directors:** Work with investor relations and legal teams to ensure you are well versed in company specifics and comfortable with the bounds of the engagement.

On the investor side, the question is whether the portfolio managers or the corporate governance teams (or both) should be involved. For many investors, these teams occupy separate silos. The portfolio manager attends earnings calls and the corporate governance professionals vote the proxies. If an investor holds the company's stock through index or exchange traded funds, it's



likely less important for the portfolio manager to attend. Why? Because no amount of engagement with directors will change any investment decisions. But for shareholders with active fund managers, involving both the relevant portfolio managers and the governance folks can signal that the engagement has broader consequences than just proxy voting.

 **Tip for investors:** *Include portfolio managers, not just corporate governance professionals.*

We sometimes hear directors complain that the investor has sent what looks like junior staff to the meeting, when they expected to see more senior personnel. But it's important for directors to understand that the ones sent to the meeting are often the ones who make proxy voting decisions. And so they are the right attendees from the investor's perspective.

 **Tip to investors:** *Explain the role that each person attending the meeting plays within the organization.*





Conduct an effective meeting—and follow up

Find the right balance

Both shareholders and directors tell us that the engagement is most productive when the shareholder does more of the talking. Directors' perspectives are important. But for many investors, their priority is to make sure the board understands their concerns.

By really listening to what shareholders have to say, directors can learn what issues their shareholders are focusing on and perhaps get an early signal of problems—issues that could spark a shareholder proposal or even draw an activist in the future.

 **Tip for directors:** Listen more than you talk.

Come with an open mind

It can be uncomfortable to hear criticisms of the company, or to feel that the board's decisions are being second-guessed by an outsider. It's natural for a person to become defensive, and even reject such views outright. But for directors, the skill of listening to shareholder concerns about the company with an open mind, rather than a defensive posture, will benefit the board and the company. Sure, the investor doesn't have the same level of detailed understanding of the company that the board and management does. But investors do offer another perspective, one that is often carefully researched and thought

through. And they may offer some very useful ideas for the director to bring back to the boardroom—or at least signal areas where the company may want to improve its disclosure.

 **Tip for directors:** Be open to hearing criticisms and new ideas.

The role of shareholder proposals

Directors often think of a shareholder proposal as a line of attack, or an escalation tactic. But some investors think of it as a first step in engagement. Once they open the line of communication with the company, they may be very willing to discuss the issue and come to a resolution that results in them withdrawing the proposal.

Follow up

The actual meeting is important, but engagement just for the sake of engagement misses the mark. For the experience to really be impactful, there is more work to be done after the meeting.

Directors who met with the shareholder can bring any suggestions or concerns they heard back to the boardroom. Then the full board can discuss the feedback. Even if the board ultimately doesn't agree with the shareholder's view, it can be helpful to look at issues from that perspective.

 **Tip for directors:** Bring the shareholders' ideas back to the full board



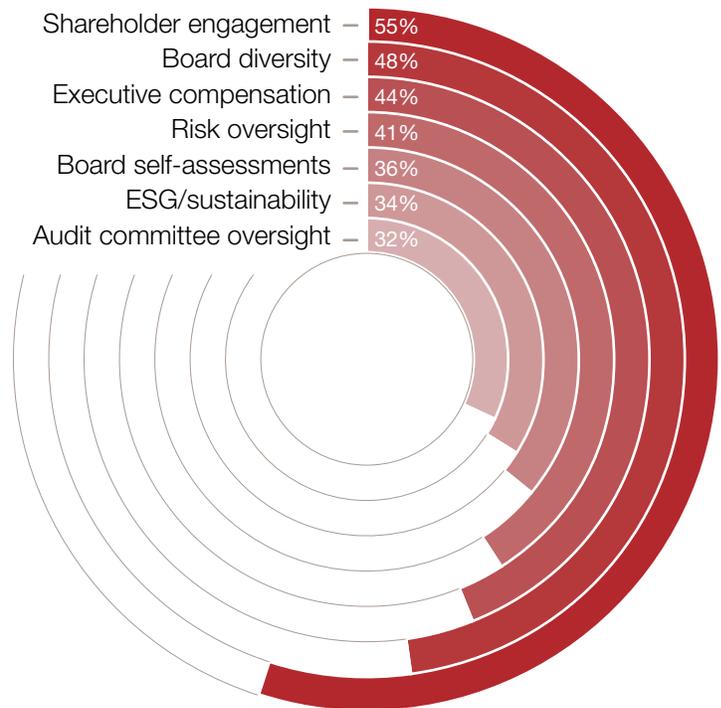
Investors, for their part, can incorporate the information they learned during the meeting into their proxy voting decisions. Or the meeting may alter the way they apply their voting guidelines to the company.

 **Tip for investors:** Follow up with any further questions—and let the company know if the engagement did or will alter any voting or investment decisions.

After the meeting, in addition to delivering on any follow-up requests from the shareholder, management can think about how to reflect the engagement in the proxy statement. Investors will know what their own engagement experience with the company has been, but they don't have a picture of the company's broader outreach. And proxy advisors don't have any visibility into private engagement at all. A fulsome description of the shareholder engagement process in the proxy statement helps to provide that context.

Some companies detail the number or proportion of shareholders they met with and whether directors participated in the engagement. They list topics or items discussed during the meetings. And they may note either the changes that the company is implementing (or considering implementing) as a result of the discussions, or its reasons against making changes. By putting some thought into the description of the engagement process, the company can demonstrate that it views the process as a useful experience, rather than a check-the-box exercise. Shareholders may be much more receptive to future engagement if they can see how past engagements made a difference at the company.

Of various types of enhanced proxy disclosure, directors think information on shareholder engagement has the biggest effect on shareholder relations



Q: Enhanced proxy disclosure: Do you believe that additional proxy disclosure in any of the following areas would improve either shareholder relations or annual meeting voting results? (Select all that apply.)

Base: 445

Source: PwC, 2017 Annual Corporate Directors Survey, October 2017.

 **Tip for management:** Describe shareholder engagement practices and outcomes in the proxy statement.

Conclusion

When done thoughtfully, engagement can be incredibly useful for both the company and the investor. An ongoing relationship, especially one formed during a non-crisis period, can benefit both sides over time.

How PwC can help

To have a deeper discussion about how this topic might impact your business, please contact your engagement partner or a member of PwC's Governance Insights Center.

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