Director Notes

Achieving a Successful Annual Meeting

by John C. Wilcox

During the past decade, the annual general meeting (AGM) has become as much a forum for confrontation with shareholders as an assembly for the conduct of company business. Today, company management and boards of directors must prepare for an array of potential disruptions to the AGM that can include organized opposition to agenda items, opportunistic investor activism, and campaigns to unseat or replace directors, which are often accompanied by negative media coverage and a tarnishing of the company's reputation. This report discusses the current environment in which companies must conduct their AGMs and offers suggestions for management and boards to help achieve a successful meeting that informs and educates shareholders.

Opinions vary widely as to whether confrontation at annual meetings is a sign of healthy corporate governance or a distraction from essential business goals. Regardless of its merits, controversy at AGMs has become a fact of life for listed companies around the world. Corporate boards and managers face a serious challenge to avoid being surprised and forced into a defensive posture or losing control of the annual meeting.

The Roots of Confrontation

Disruptive annual meeting tactics started in the United States as a grass-roots methodology used primarily by small shareholders, labor unions, and special interest groups. These gadfly campaigns had little impact until prominent institutional investors joined the corporate governance movement in the mid-1980s. Annual meetings gave these institutions an ideal platform to promote governance reforms, strengthen shareholder rights, and call attention to egregious corporate practices. Over time, the successful use of these aggressive tactics has transformed the annual meeting to the point where it is now viewed as a quintessential corporate governance event.[1]

1 For example, Richard Jerome, "Evelyn Y. Davis," *People*, May 20, 1996 there: (http://www.people.com/people/archive/article/0,,20141327,00.html); John D. Stall, "Ford's Gearhead Gadfly May Skip the Annual Meeting," *Reuters*, May 9, 2012 (www.reuters.com/article/2012/05/09/us-ford-gadfly-idUSBRE8480JI20120509); and "Disruptive Tactics at Company Annual Meetings Stepped Up," HR Policy Association, May 18, 2012 (www.hrpolicy.org/position_issue_newsstory.aspx?rid=835&iid=1302).

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Against this background of long-term trends, today's activism has been intensified by the macroeconomic issues and unstable market conditions that affect companies around the world. These conditions create an unusually difficult global context for companies planning their annual meetings in 2013.

Shifts in the rights and powers of shareholders and boards Three decades of successful activism and corporate governance reforms have permanently realigned the rights and powers of shareholders and corporate boards. Institutional investors are expected to oversee and engage with portfolio companies; corporate directors are expected to be fully informed and responsive to shareholder concerns. Global corporate governance standards have eliminated the old "Wall Street Rule" and companies can no longer tell dissatisfied shareholders to mind their own business or invest elsewhere.

Shifts in shareholder demographics Changes in shareholder demographics have concentrated voting power in a powerful cadre of global institutional investors.[2] Even hybrid companies in developing markets—those with family ownership, majority control groups, voting agreements, or state-owned "golden shares"—will usually find among their minority shareholders some sophisticated global investors who bring critical perspectives, diverse investment strategies and a wide range of attitudes toward governance and activism.

The influence of proxy advisory firms Proxy advisory firms have become a permanent fixture, facilitating the exercise of shareholder voting rights, highlighting poor corporate governance practices, and strengthening support for shareholder initiatives. The prolonged global debate over whether proxy advisors have too much power and whether they should be regulated is beside the point. Whether or not regulators in Europe or the United States impose new standards, proxy advisors are here to stay. Companies in all markets must develop effective ways to counter their limitations.

Say on pay The global spread of say-on-pay voting rights (SOP) has done more than any other issue to transform the dynamics of annual meetings. SOP legitimizes shareholder scrutiny of companies' compensation decisions, which have come to be regarded as a reliable gauge of board competence and independence. Shareholders now routinely use their SOP votes as a lever to hold boards accountable on a wide range of governance and performance issues. Directors must be prepared to explain and defend their pay decisions in terms of performance metrics and strategic business goals.

Imperial CEOs Celebrity CEOs and excessive CEO pay at high-profile companies in developed markets have alienated shareholders, attracted negative media attention, and generated widespread public resentment of business leaders. While rooted in broad cultural trends, the problems of overpaid imperial CEOs, high CEO turnover, and mistrust of business create serious challenges for corporate boards and fodder for activists.

Inefficient financial markets Despite the lessons of the financial crisis, stock markets and new trading platforms continue to give precedence to opaque speculative practices and high-frequency equity trading that are disconnected from listed company fundamentals. These activities erode essential market functions of capital raising, liquidity and equity valuation. In addition, derivative investment strategies give rise to the possibility of "empty voting"—decoupling voting rights from stock ownership and economic interest—that will undermine core governance principles. Regardless of these market distortions, companies are still under an obligation to manage investors' expectations and deal with stock price volatility, undervaluation and other market dysfunctions.

Global ownership Globalization of the investment process has added complexity and inefficiency to the logistics of shareholder meetings. Today's cross-border proxy system is a multi-layered morass of intermediaries, third-party agents, proxy advisory firms, voting platforms, and opaque back-office operations that operates with little regulatory oversight. Under these conditions, companies with global ownership have little choice but to dedicate significant time and resources to their annual meetings, even when no controversy is expected.

Stewardship Codes and Principles of Responsible Investment The advent of Stewardship Codes and Principles of Responsible Investment have turned a spotlight on the governance and conduct of institutional investors.[3] These new and evolving standards for investment managers—which emphasize transparency, engagement, and responsible exercise of voting rights—increase pressure on portfolio companies in the form of closer scrutiny of AGM agendas and higher levels of shareholder participation at annual meetings.

2 Matteo Tonello and Stephen Rabimov, *The 2010 Institutional Investment Report: Trends in Asset Allocation and Portfolio Composition*, The Conference Board, Research Report 1468, November 2010.

3 For example, see the UK Stewardship Code, published by the Financial Reporting Council in July 2010 and revised July 2012 (http://www.frc.org.uk/Our-Work/Codes-Standards/Corporate-governance/UK-Stewardship-Code.aspx), and the Principles for Responsible Investment backed by the United Nations (www.unpri.org/principles).

Environmental, social, community and governance (ESG) policies There is growing interest in the intangible, non-financial aspects of corporate conduct and performance, including sustainability, and environmental, social, community, and governance policies (ESG).[4] Although ESG issues are important to companies, most analysts and portfolio managers are reluctant to give them equal billing with earnings, stock price, and traditional financial metrics. Companies must therefore deal with contradictory messages from institutional investors: governance activists want more attention to ESG, while portfolio managers and analysts continue to focus on earnings and stock price.

Short-termism A persistent and widespread focus on short-term performance has distorted the incentives, metrics, and strategic focus of both companies and investment professionals. Companies are told to manage for the long term but are judged on the basis of short-term results. After years of finger-pointing and rhetoric about short termism, there is a growing consensus that all parties—financial market professionals, as well as companies—must take responsibility and modify their practices in ways that will "break the short-term cycle."[5] Companies should anticipate that activists will make the need to modify short-term incentives an increasingly important part of their agenda.

Spread of the U.S. governance model The adversarial and legalistic U.S. governance model—with its detailed and prescriptive rules, strict compliance, and systemic reliance on shareholder resolutions and litigation—continues to spread globally. U.S. institutional investors' increasing presence in developing markets will bring activism and combative tactics to the shareholder meetings of companies outside the United States.

This long list of trends and conditions that promote controversy, aggressive conduct, and activism at AGMs is tempered by the principles-based corporate governance system that prevails in countries outside the United States. Principles-based governance and its comply-or-explain methodology encourage board-level dialogue, consensus decision making, and flexible implementation of governance policies. This flexibility can take the edge off of activism and make it easier for companies to avoid confrontation with shareholders. Nevertheless, as the European Commission cautioned in its second Green Paper in 2011, comply-or-explain governance is only as effective as the explanations that companies are willing to provide.[6] The Commission found that in many cases of noncompliance, companies have provided little more than "group-think" and boiler-plate instead of meaningful explanations for their decisions. Weak explanations provide fertile ground for confrontation and activism by shareholders.

Rethinking the AGM

In rethinking their AGMs, managers and boards should not only question their most basic assumptions and attitudes about shareholders, but also the purpose of the annual meeting. The goal of the AGM should be to initiate and manage the process of change, rather than reacting to external pressure.

Development of a new and constructive mindset toward the annual meeting should begin with the following basic dos and don'ts:

Don't think about shareholders collectively Analyze your ownership base with a view to understanding shareholders' diverse characteristics, investment goals, and track record on activism and governance issues. Understanding your audience is critical to preparing an effective message and gaining support at the annual meeting.

Don't assume that shareholders want to use the annual meeting to micromanage your business In most cases, the opposite is true: shareholders want the board and management to run the business, but they also want sufficient information to make an independent judgment that the job is being done well. Their goal is to cast an informed vote on agenda items, particularly the election of directors.

Don't let activists dominate your thinking about shareholders Rather than worrying about speculators, hedge funds, and activists, companies should focus on attracting and retaining the long-term investors who will generally support the company's annual meeting agenda.

4 Thomas Singer and Matteo Tonello, *Sustainability Practices: 2012 Edition*, The Conference Board, Research Report 1493, July 2012.

5 Dean Krehmeyer, Matthew Orsagh, and Kurt N. Schacht, "Breaking the Short-Term Cycle," CFA Centre for Financial Market Integrity/ Business Roundtable Institute for Corporate Ethics, July 2006 (www.cfapubs.org/doi/pdf/10.2469/ccb.v2006.n1.4194); and "Overcoming Short-termism: A Call for a More Responsible Approach to Investment and Business Management," The Aspen Institute, September 9, 2009 (www.aspeninstitute.org/publications/overcoming-short-termism-call-more-responsible-approach-investment-business-management).

6 European Commission Green Paper, "The EU Corporate Governance Framework" (http://ec.europa.eu/internal_market/company/docs/modern/com2011-164_en.pdf).

Benchmark your company's governance policies and practices against peer companies and global standards Conduct a perception study among your largest institutional investors if a controversial proposal is on the agenda. Understanding your strengths and weaknesses relative to other companies will enable you to anticipate shareholder concerns, prepare an appropriate proxy solicitation campaign, and counter the effects of negative vote recommendations from proxy advisors. As a nonadvocacy, independent, not-for-profit research organization, The Conference Board documents the development of board practices of U.S. companies and publishes annual benchmarks that can assist companies in the benchmarking process.[7]

Be unsparing in your internal analysis of conflicts of interest, related-party transactions, ethical problems, accounting policies, performance shortfalls, whistle-blower initiatives, and other sensitive and confidential matters Be prepared to respond appropriately in case these issues arise at the annual meeting.

Be sparing in the use of outside advisors for assistance on the board's core governance responsibilities, such as compensation, director recruitment, CEO succession planning and accounting policy Third parties should not be in the driver's seat on issues for which shareholders hold the board of directors primarily accountable.

Initiate dialogue with institutional investors and proxy advisors Listen to their views, but don't look to institutional investors or proxy advisors for guidance. A company's management and board understand the details of their business better than shareholders. However, managers and directors often do not understand how the business is perceived externally. Outreach and engagement with shareholders is the most effective means to deal with misperceptions and avoid negative surprises at the AGM.

Give directors a voice and a defined role at the annual meeting Traditions of boardroom collegiality and privacy should not prevent directors from engaging with the shareholders who elect them. In addition to the annual report and meeting agenda, boards should consider providing a written report that describes the directors' expertise and competence, explains their decision-making processes, and informs shareholders about critical governance issues: compensation, succession planning, related-party transactions, split chair and CEO roles, and other governance hot topics.

Don't let legal constraints or competitive concerns override transparency in your annual meeting disclosure documents A principles-based "explanation" that gives confidence to shareholders should (i) provide a clear and detailed articulation of the company's business strategy and goals, (ii) explain how the board's policies and decisions relate to the strategy and goals, and (iii) make a persuasive case that these policies and decisions will benefit shareholders.

Start AGM preparations early Don't underestimate the resources and expertise required for an effective cross-border solicitation campaign. Use the company web site and all available technology to facilitate information flow and share voting. Activities should be coordinated with the corporate governance, investor relations, and human resources programs.

This basic advice may sound like "Annual Meetings for Dummies," but in today's unstable, high-pressure environment, it has proven remarkably difficult for companies to establish and reinforce both shareholder and public trust and make productive use of their AGMs.

The New Annual Meeting

A simple motto—"Treat shareholders as customers"—is the key to managing a successful annual meeting. Companies rethinking their AGM can often find a useful model in their own market research, marketing, and customer relations activities. Planning for the AGM should begin with basic research and benchmarking that can provide answers to critical starting-line questions:

- Who are the company's ultimate beneficial owners?
- What are their characteristics and investment goals?
- What are their perceptions about the company?
- How can their misperceptions and biases be corrected?
- How does the company's risk profile, governance, and performance compare with competitors?
- How can the company convince shareholders that its policies and decisions serve their interests?
- What sort of packaging, written materials, outreach, road shows, and electronic communications can be used to build loyalty and strengthen relations with shareholders/customers?

7 Matteo Tonello and Judit Torok, *The 2011 U.S. Director Compensation and Board Practices Report,* The Conference Board, Research Report 1486, November 2011.

Just as companies dedicate executive time, money, and resources to conducting market research and surveying customers, they should also be willing to commit resources and underwrite the costs of identifying, characterizing and analyzing their ownership base; and to benchmarking their governance strengths and weaknesses in preparation for the AGM.

Another model for AGM planning can be found in companies' investor relations (IR) programs. However, it is wrong to assume that the AGM can piggyback on investor relations contacts and road shows developed for financial communications. A successful IR program is generally not a path to establish relations with investors' policy and voting decision-makers. The opposite is often true. Many institutional investors suffer from the so-called "split-brain" syndrome that creates an unbridgeable gap between their investment decisions and their voting decisions. To deal with this gap companies have two choices: (1) they can develop an expanded form of holistic investor relations that addresses both governance and nonfinancial issues (the board perspective), as well as the financial expectations of investors (the management perspective); or (2) they can create a separate institutional investor relations program, independent from IR, that works with the company secretary and the board of directors to engage with shareholders on ESG and other board-level issues. Both holistic IR and institutional investor relations programs require an expanded level of communication from the board of directors that should not duplicate or conflict with communications from management. Both approaches require outreach to an unfamiliar audience that includes governance policy makers and an array of third-party agents, custodians, proxy advisory firms, and other intermediaries who assist them in proxy voting. Many of these players are difficult to identify or reluctant to engage with companies.

For a successful AGM, companies must be willing to simplify, clarify, and amplify the information they provide in support of their policies and decisions. The existing comply-or-explain standard does not go far enough. Companies should not limit their explanations to noncompliant policies. Instead, they should provide a customized, comply-and-explain narrative that tells a compelling story of how the company is being run, where it stands competitively, and how its board-level policies and decisions are linked to business goals. [8] Executive remuneration is a case in point.

8 For example, see the discussion about a written annual "Directors' Discussion and Analysis" in John C. Wilcox, "Comply-and-Explain: Should Directors Have a Duty to Inform?" *Law and Contemporary Problems*, 74, no. 1, Winter 2011, pp. 149-160.

The board of directors, as the elected representatives of shareholders, should take primary responsibility for producing a narrative that explains the company's culture and values and describes the internal processes by which governance serves business strategy.

The elements of a successful annual meeting should also include improvements in cross-border logistics that are beyond the reach of individual companies. Some form of global initiative will be needed to achieve a more open and less costly process for cross-border communication and share voting. Long-sought goals—end-to-end vote confirmation, a vote audit trail and identification of beneficial owners—will remain elusive until global standards can be established through harmonized regulation and enforceable standards of best practice.

Conclusion

Theoretically, the annual meeting should be a litmus test that reveals whether shareholders support the company's governance and business strategy. The level of shareholder support at the AGM should measure the degree to which the interests of the company and its shareholders are aligned. In practice, however, this correlation is rarely achieved. Many obstacles stand in the way. Mechanical and systemic complications, inadequate regulation, shareholder apathy, legal and cost concerns, poor communication, a compliant mindset, and fear of shareholder activism can all contribute to less than optimal results at AGMs. These conditions are likely to worsen as macro-economic conditions, increased regulation, and stewardship codes increase pressure on both companies and shareholders.

In the final analysis, responsibility for a successful AGM rests with each company's management and board. They should make certain that the AGM is a platform that informs and educates shareholders, explains the links between governance and business strategy, brings transparency to boardroom processes, and eliminates contentious issues before they develop into activism. A successful AGM should be a customized and highly individual event that demonstrates the company's commitment to serving shareholder interests while giving priority to the achievement of business goals.

About the Author

John C. Wilcox is chairman of Sodali Ltd, a global consultancy providing companies and boards with services relating to corporate governance, shareholder relations, corporate actions and the capital markets. From 2005 to 2008 he served as senior vice president and head of corporate governance at TIAA-CREF, one of the world's largest private pension systems. Prior to joining TIAA-CREF, he was chairman of Georgeson & Company, the U.S. proxy and investor relations firm. During his career he has specialized in corporate governance, capital markets regulation, director education, cross-border standard-setting and investor communication, providing expertise in both corporate and shareholder perspectives.

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About the Series Director

Matteo Tonello is managing director of corporate leadership at The Conference Board in New York. In his role, Tonello advises members of The Conference Board on issues of corporate governance, regulatory compliance, and risk management. He regularly participates as a speaker and moderator in educational programs on governance best practices and conducts analyses and research in collaboration with leading corporations, institutional investors and professional firms. He is the author of several publications, including *Corporate Governance Handbook: Legal Standards and Board Practices,* the annual *U.S. Directors' Compensation and Board Practices* and *Institutional Investment reports, Sustainability in the Boardrooom,* and the forthcoming *Risk Oversight Handbook*. Recently, he served as the co-chair of The Conference Board Expert Committee on Shareholder Activism and on the Technical Advisory Board to The Conference Board Task Force on Executive Compensation. He is a member of the Network for Sustainable Financial Markets. Prior to joining The Conference Board, he practiced corporate law at Davis Polk & Wardwell. Tonello is a graduate of Harvard Law School and the University of Bologna.

About the Executive Editor

Melissa Aguilar is a researcher in the corporate leadership department at The Conference Board in New York focusing on issues of corporate governance, regulatory compliance, and risk management. Prior to joining The Conference Board, she was a contributor for more than five years at *Compliance Week,* where she reported on a variety of corporate governance topics, including proxy voting developments, executive compensation, risk management and shareholder activism. Her work has also appeared in *Bloomberg's Bloomberg Brief Financial Regulation* newsletter. Previously she held a number of editorial positions at SourceMedia Inc.

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For more information on this report, please contact:
Melissa Aguilar, researcher, corporate leadership at 212 339 0303 or melissa.aguilar@conferenceboard.org

THE CONFERENCE BOARD, INC. www.conferenceboard.org
AMERICAS +1 212 759 0900 / customer.service@conferenceboard.org
ASIA-PACIFIC +65 6325 3121 / service.ap@conferenceboard.org
EUROPE/AFRICA/MIDDLE EAST +32 2 675 54 05 / brussels@conferenceboard.org
SOUTH ASIA +91 22 23051402 / admin.southasia@conferenceboard.org

THE CONFERENCE BOARD OF CANADA +1 613 526 3280 / www.conferenceboard.ca

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