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VIEWPOINT

Directors Discuss the Evolving Role of the Board in Shareholder Engagement

by Steve Chan and Michelle Tan |

Richard DeWolfe

Margaret Foran

Shareholder engagement remains highly topical in boardrooms across North America. Issuers are recognizing the benefits of speaking directly with institutional shareholders on a broad range of topics beyond financial results, particularly in today's environment of increasingly influential proxy advisors and the ever-present specter of activists.

The task of engaging with shareholders used to rest with investor relations and senior management. But recently, directors have become more involved in engagements, particularly on matters related to the board, the CEO and executive compensation.

To provide perspective on the director's role in engaging with shareholders, Steve Chan and Michelle Tan of Hugessen Consulting spoke with Richard DeWolfe, chair of the board of Manulife Financial Corp., and Margaret Foran, chief governance officer of Prudential Financial and chair of the governance committee of Occidental Petroleum Corp.

The role of directors in shareholder engagement is evolving. Who should lead engagements with shareholders?

DeWolfe: I prefer to engage shareholders on behalf of the board without the presence of management. This allows investors to express any concerns that they may have to the board directly—not filtered by management, not couched in language that management may find concerning or offensive. I have maintained a practice of having the head of investor relations (IR) accompany me for the purpose of listening and taking notes.

Foran: I believe that, as a starting point, the majority of engagements should be led by management, whether the corporate secretary or IR. If you talk with your top investors, most will say that it is not absolutely necessary to have a director involved in an engagement. Obviously, there are certain topics that the board needs to be involved in, including executive compensation, CEO pay, and succession. It's hard to talk to the CEO or someone who reports to the CEO about their own pay.

Should directors directly engage with shareholders? Why or why not?

DeWolfe: We can find 1001 excuses why directors shouldn't speak with shareholders. Directors are there to represent shareholders' interest, so it seems ridiculous that there wouldn't be an obligation on the part of the board to communicate with shareholders. One of the dangers of ignoring shareholders is hastening the arrival of activists.

I encourage all board members to act as observers in any and all investor presentations, to listen and understand the concerns of shareholders. However, not all directors are the best communicators in the sense of being able to articulate the issues or answer questions from shareholders. There should be a few directors who are designated spokespersons for the board and responsible for leading these discussions. This is one of the skills boards should consider as they recruit directors.

Foran: I go back to what I initially said: a lot of this can and should be done by management. There are some instances and there are some subjects that are harder to [discuss] without a director. Also, some investors want to talk to board members, so I think that to categorically say "never" [directly engage] is probably wrong. I think boards have to keep an open mind. I also agree that if you're not prepared, then it can be a real negative [experience]. Every one of the institutional investors I know has stories of directors who have just been horrible [to work with]. At the same time, a good director who shows oversight, independence, and knowledge of the issue, and is a good communicator is a real plus. A real negative is having a meeting where the director does not do a good job, and at that point, it would be better to not have a director present at [at a shareholder meeting].

Smaller shareholders tend to rely more heavily on the proxy advisors. How can directors effectively engage with this part of the shareholder base?

Foran: Engagement is not just meetings, be it with management or board members. You engage through your proxy statement, your website, and letters, and I think people underestimate the effect that these venues can have. At Prudential, we have a letter to our shareholders from our board as well as the lead director [in the proxy statement], in addition to a video from the lead director that we embed in the proxy statement on our website. That video has gotten an unbelievable number of hits. For some of the smaller shareholders that may not have time or resources to engage, receiving a letter with the video link [to say], "We can't engage with everyone, we just wanted you to see this, and if you have any feedback, let us know" can be very powerful.

What are your thoughts on engaging with the proxy advisors?

DeWolfe: We undertook engagement with the proxy advisors this year for the first time and I thought it was really helpful. First of all, we found them very responsive. We wanted to address concerns that they had raised about our proxy, and it gave us an opportunity to better understand how their judgments are formed. It gives you an opportunity to discuss your point of view on those things. And I think it would be helpful if more companies did engage them so that [the proxy advisors] were not simply making these judgments, or publishing opinions, without an opportunity to discuss how that advice was formulated.

Any advice for boards who expect to receive a negative say-on-pay recommendation from a proxy advisor? Can engagement with shareholders and/or proxy advisors help mitigate this?

DeWolfe: What I would say is that you can't formulate your pay for performance on the basis of what you think the proxy advisor is going to say. You have to design your compensation systems on the basis of the economics of your business and what you believe will fairly reward management while maintaining the best interest of the shareholders.

If you know that your approach is likely to result in a "no," it makes sense to engage key shareholders in advance. My suggestion is that it's easier to explain your position up front rather than falling back and being criticized and then having your explanation seem like an excuse.

Foran: Don't underestimate your disclosure. Proxy advisors and shareholders read proxy statements very closely. It's like a test. Even though you may fail the multiple choice [section], if you have a good story, then you are probably going to get extra credit on the essays.

It is much better to make the extra effort and do a great job of telling your story in the proxy, and perhaps reinforce that with a meeting with investors and proxy advisors, than have to use a meeting to try to fill in the gaps in your proxy. To me, a good offense is better than a good defense, so figure out what your investors and the proxy advisors look at and address [those items] in the proxy statement.

People like to hate the proxy advisors, but they are just doing their job. If you are really unique, you need to tell that unique story. If you are going to fail on the quantitative tests, then tell that really good story, and that story is a board story, one the board believes in. You need to light the candle instead of cursing the darkness.

Is shareholder engagement an effective tool in dealing with activist shareholders?

DeWolfe: Director-led shareholder engagement allows boards to get ahead of being the subject of an activist attack. If your board knows the expectations of shareholders in advance, you're on far safer ground than if you decide to hide in the boardroom and ignore shareholder expectations.

How would you describe your general experience with shareholder engagement?

DeWolfe: Going back probably 10 years ago when this really became a question for the board, my view was that having engagement was better than not having any engagement. However, you can't just say "Well, we are going to have an engagement program," and then go off and do it. It needs to be carefully planned and orchestrated to ensure that you are talking to the right people, covering the right bases, keeping track of the subjects of interest and ultimately using that as a way of guiding management in terms of meeting shareholders' expectations. At the end of the day, it's really using the board to keep management apprised of shareholder expectations and vice versa so people aren't surprised. The only surprise people like is a birthday present.

Foran: I started doing this years ago when I was at Pfizer, starting with a meeting with the lead director and chairs of the committees with our top 30 investors. We invited them to Pfizer for an afternoon event and cocktails. This was in 2007, and one law firm called it "governance run amuck". Now look where we are today.

If you talk with the major institutional shareholders, they will tell you that a rapidly increasing number of their engagements involve board members. So you see engagement evolving. People shouldn't go crazy, but there are certainly companies and instances where it makes a lot of sense.

This article also appears in Director Journal*, the official publication of the Institute of Corporate Directors.*