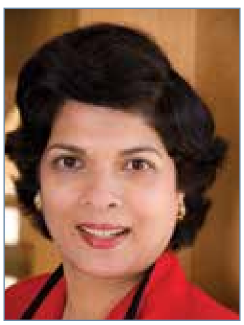
How to Engage Investors for Long-Term Value Creation

By Sheila Hooda



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The success of a business depends on understanding and promoting collaboration among three lead players: management, which develops the company's long-term strategy; the board, which oversees the implementation of that strategy and acts as a fiduciary for shareholders; and institutional investors, which hold the board accountable. These players' interests and a mutual understanding of the company's long-term strategy must align to create a partnership of transparency, trust, and respect. Since corporations and institutional investors are large organizations, there needs to be effective governance policies and protocols to foster constructive investor engagement.

But do boards and management have a deep enough understanding of institutional investors' expectations and priorities to foster effective engagement? Are they organized to best manage engagement? Institutional investors are often not provided with the information they need to see the company's vision or the link between short-term initiatives and long-term strategy. This could contribute to their focus on short-term results in the foreseeable future.

On the corporation side, an investor relations team traditionally interacts with portfolio managers while the corporate secretary or general counsel deals with corporate governance matters. Management-investor communications are typically limited to quarterly calls that focus broadly on recent financial results, while boards tend to have limited interaction with institutional investors. On the institutional investor side, corporate governance teams typically lead governance discussions to inform voting decisions while portfolio managers focus on investment decisions. As a result, these institutions may be lacking in the coordination and organization required to engage, raise, and hear concerns about long-term strategy, or to provide and respond to feedback.

Surveys by Equilar and PwC indicate that more than 60 percent of S&P 100 companies disclosed some form of shareholder engagement in their 2016 proxies, up from 2 percent in 2011. The enactment of the Dodd-Frank Act, the rise of activist investors, and the influence of proxy advisors have all played a role in this increase in engagement. However, improving the quality of engagement will only result from a structured, well-thought-out approach where the company issues communications that are consistent and transparent and hears what is on investors' minds and responds to their feedback.

The board and management should communicate to investors the long-term strategy with a clear emphasis on long-term, sustainable value creation. There should be discussion of the strategic vision and direction of the company, its goals and outcomes, the broad business model implications, the required capital allocation and investment, risk scenarios, and time frames. Emerging risks like cyber threats, digital and automation disruption, and plans involving the skills and talent changes required to deal with disruption also need to be part of the discussion, as applicable. Metrics and milestones for progress need to be communicated and high-level accountabilities discussed.

Boards, management, and institutional investors need to recognize the wider context for sustainable long-term success with other stakeholders including customers, employees, the community, and the supply chain. Environmental and social governance (ESG), corporate social responsibility (CSR), and human rights considerations also need to be woven into the long-term strategy, as sustainable financial performance results from good ESG and ethical treatment of all stakeholders. Further, the role of the business leadership team in developing and implementing the strategy needs to be articulated. The board's role in these processes should be reinforced.

Communications to this effect will provide institutional investors with a clear understanding of the company, its direction, and how it intends to create long-term value. It will also give them benchmarks to judge performance and progress, and to evaluate feasibility of that direction and the associated risks. With this increased communication, they will have the opportunity to "buy in" to the long-term strategy and provide feedback. As a result, these communications will establish a basis for future dialogue and engaged ownership.

An important benefit of relationship building in this way is that investors will consider quarterly results in the context of strategic long-term objectives. In addition, boards and management will have the credibility to get institutional investor support and, if needed, capital for long-term investments. It will also help shore up support for the company well in advance in the event an activist hedge fund pushes for changes that lack the perspective of the long-term strategy.

Good governance is the bedrock for the long-term sustainable success of a corporation. In the current business and socio-political context, investor engagement and governance dialogues should be broadly centered around:

- the role of the board, its independence from management, and its composition, which should include discussion of diversity and director tenure;
- talent management, including board leadership and CEO succession;
- executive compensation philosophy and design, and how it is linked to a long-term strategy that attracts and retains talent while incenting for long-term results and performance; and
- sustainability, ESG, and CSR.

In view of recent initial public offerings such as Snap's, we should expect a dialogue regarding governance structures and voting rights (e.g., dual and multi-class shares) and possible sunset provisions.

Further, as part of the engagement around governance and board leadership, institutional investors should be given an opportunity to discuss their concerns and hear the board's and management's rationale for its decisions. Boards and management should listen to investors' insights and provide feedback on the key themes that arise.

Who within the organization should be conducting these efforts? How this responsibility is distributed is largely dependent on the issues that investors have raised. For topics on strategy, performance, financials, and risk, it is best to have the CEO or a C-level executive discuss with investors. On matters concerning compensation, audit, shareholder rights, and governance, a designated board member like the lead director or a committee chair would be in the best position. With appropriate preparation and planning, typical concerns regarding Regulation Fair Disclosure compliance can be addressed.

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The timing and channels of communication are also important in shaping a dialogue among these three lead players that builds trust, transparency, and credibility. In this context it is important to have a good understanding of the investor base. The concentration of the investor base, the specific focus of the investor segments, and their desired mode of engagement need to be considered. Engagement that is conducted throughout the year with consistent messaging is always most effective. Because engagement will vary by company and across investors, each engagement needs to be balanced for effectiveness, staffing, and practicality, which can include:

- in-person meetings and calls, typically with a select group of the largest institutional investors;
- more interactive, two-way dialogue at quarterly earnings calls and investor day presentations, where information and discussions are had within the context of the long-term strategy, typically for bigger groups of investors;
- occasional letters to investors on topics involving long-term strategic decisions and potential financial implications;
- annual reports and proxy filings that clearly focus on financial results and metrics within the context of the long-term strategy, ideally with simple graphics; and
- virtual meetings for large groups.

Major investors are increasingly expecting direct access to the board; policies and arrangements to this effect will vary by company. Boards will need to be supported by their internal legal, corporate governance, and institutional-investor personnel when such requests are made.

If an institutional investor remains concerned about a board's governance practices, management's articulation of the long-term strategy, or subpar financial performance, the investor should promptly and proactively seek to engage with management and the board. Privately engaging over concerns in a spirit of constructive collaboration will help further the long-term goals of the company and the investor.

Effective engagement between the board, management, and institutional investors is at the heart of good governance. For the company, transparent communications will ultimately alleviate short-term pressures for profit maximization and encourage long-term strategic planning, investment, and capital allocation. For investors, they provide a holistic understanding of the long-term strategy, the conviction to withstand business downturns, and a platform to voice their thoughts and concerns. D