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Shareholder Engagement: Maximizing the Shareholder Relationship

By Tarun Mehta, Advisor, ISS Corporate Services

Shareholder engagement has taken center stage based on recent regulatory and corporate governance trends. The relationships between shareholders and issuers deserve more attention than most companies give; the impact of those relationships could have material consequences for both sides. Shareholder engagement, for purposes of this discussion, includes efforts made by companies to engage with their shareholders on a wide range of topics including executive compensation, strategy, risk management, corporate governance, and other topics falling outside of the usual financial and strategic conversations.

Shareholder engagement is important to investors

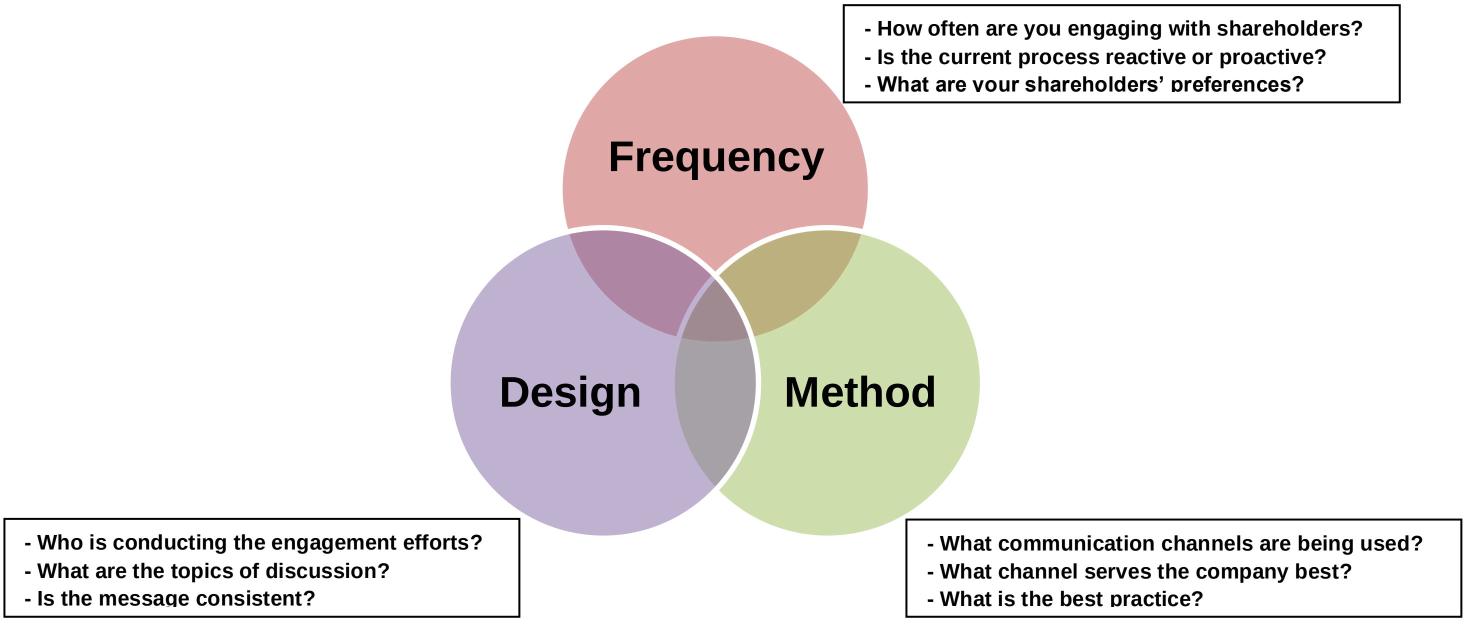
Institutional investors hold shares on the behalf of millions of individuals and other entities, and they have a fiduciary duty to ensure that their holdings are in the best interest of the underlying investors. But this responsibility doesn't end with financial performance; rather, it extends to ensuring that the companies they invest in have adequate corporate governance mechanisms. Additionally, in the wake of the financial crisis, institutional investors are under increasing pressure to understand the companies in which they invest and use their influence to minimize corporate governance risk.

> Issuers often fail to recognize the value of effective shareholder engagement and the degree of influence they have in shaping their shareholders' perspectives.

The "standard" approach to shareholder engagement has often led to a contentious relationship between investors and issuers. Companies typically engage with shareholders only during scheduled shareholder events, such as the annual shareholder meeting, analyst calls, or public announcements. These engagements tend to be mere formality and of little value, as they do not translate into positive votes at the annual meeting. Outside of these traditional forms of communication, communication with shareholders is, more or less, limited to times of crisis or when performance issues arise.

Three factors are the hallmark of a successful shareholder engagement program

Research indicates these factors as most critical behind successful shareholder engagement:



The benefits far outweigh the costs

Ongoing shareholder engagement *throughout the year* provides several benefits.

Institutional investors are more receptive and likely to support Management's positions when the company has been in contact with them periodically over the course of the year. Although shareholder engagement may not always garner immediate results, it has the potential to lead to mutual agreements on various matters over time.

Being in regular contact benefits both parties by facilitating a better understanding of the company (for shareholders) as well as the views and policies of its institutional shareholders (for issuers). If the only time your company reaches out to shareholders is when something bad is happening or about to happen, you can expect them to be wary to engage with and support you.

> The most effective way to anticipate the impact of shareholder votes and proxy advisory firm recommendations is to create opportunities to meet with shareholders *throughout the year*.

Progressive companies that are at the forefront of the market recognize this ***paradigm shift*** and are proactively making efforts to engage with shareholders *throughout the year*.

Management Say-on-Pay proposals provide a great example of where the benefits outweigh the costs – even though they can be difficult to quantitatively measure. Especially for companies that have experienced low support for their say-on-pay proposals – and anything less than 80% qualifies as "low support" from a relative perspective. Board responsiveness to low support levels, as gauged by ISS

Research, is heavily dependent on the level of shareholder engagement the company has exhibited. Equally important are the concerns expressed by shareholders and how the company addressed them. Consequently, more frequent communication leads to a better understanding and higher comfort level, particularly on such a sensitive issue such as executive compensation. It's no coincidence that companies who have consistently received over 90% support on the past three years of say-on-pay usually have a robust shareholder engagement process.

Shareholder engagement is a distributed responsibility

> Your "Investor Relations" head is often the last person that an institutional investor wants to engage with regarding substantive issues.

The design of shareholder engagement efforts is another key factor in the engagement process. This leads us to who within the organization should be coordinating and conducting these efforts. The answer to this question is dependent on the issues at hand. For example, when engaging with shareholders on topics of strategy, performance, or boardroom independence, it is generally best to have Management, particularly the CEO, whose intimate knowledge of strategic issues and familiarity with day-to-day operations, meet with shareholders.

Conversely, on issues regarding executive compensation, shareholder rights and other corporate governance matters, specific Board members, such as the Lead Director, Chairman (if "independent"), or Chairs of certain committees, would be best positioned to engage with shareholders.

CEO / NEOs	Chairs of Committees	Entire Board
• Strategy • Operations • Performance • Risk management • Board composition • Business objectives	• Executive compensation • Audit and accounting issues • Equity risk mitigation • Communication and disclosure	• Board practices/policies • Board composition • Takeover defences • Related party transactions • Management oversight • Shareholder proposals

The Management team is in the best position to have the first conversations and begin the engagement process as shareholders tend to be more receptive to higher profile individuals.

Once Management receives a positive response that shareholders want to have an engagement, it is best to then assign the coordination activities with the appropriate staff and ultimately decide who will conduct the meetings. It is important to note that regardless of who meets with shareholders, the company's representatives should be on the same page in terms of communicating a consistent message. This is especially important in order to mitigate the risks of violating Regulation FD.

> Regulation FD (Fair Disclosure) mandates that when an issuer discloses material nonpublic information to certain shareholders, it must publicly disclose that information to all shareholders.

How you choose to engage makes all the difference

The method in which the engagement occurs is another key consideration. Most successful companies take a portfolio approach to working with their shareholders, combining methods that focus on mass investment community outreach, targeted investor communication, and individual investor conversation.

But not all companies invest the same energy into each of the communication categories; the distribution of effort is often influenced by three important factors:

1) Concentration of investor base
2) Familiarity with current investor base / Investor base activism
3) Satisfaction with current investor base

The concentration of the investor base is an important consideration. The more concentrated the investor base, the more productive individual investor conversations will be; senior executive time becomes very scalable. However as investor bases become less concentrated, more “mass investor” communications become more productive – things like investor days or “fifth calls.” These calls, which are in addition to the typical quarterly financial results calls, are board conversations targeted directly at investors. “Virtual meetings” often provide a middle ground between the two.

Companies that need to attract additional capital, or are looking to make a change in their investor base, will typically use annual conferences and road shows more often. Road shows can take significant time commitments from senior executives, and can be quite expensive to execute – but can deliver good results in terms of solidifying a high-quality investor base.

Empowering shareholders beyond the annual meeting can broaden and deepen existing relationships, whereby ensuring the stock price reflects its true value as closely as possible.

Companies that have material concentrations of activist investors also tend to shift their focus to increased individual investor conversations – even if the activists aren't large institutional holders.

Companies with a history of high shareholder support on management proposals evaluate all these factors and *use a combination of all the methods* described above to maintain strong ties with their shareholders and achieve maximum results from their engagement efforts.

Participation makes prepared

Preparation, oftentimes, becomes the most critical aspect of the engagement process. Prior to actually contacting shareholders, companies should conduct research to determine which issues are of concern to its top shareholders, their standard policies, and their voting patterns on such issues.

Demonstrating that the company has taken time and effort to understand its shareholders' positions is sure to create good will and lead to a more productive and collaborative engagement. The agendas for such meetings should also be prepared in advance and limited to specific issues and/or topics, rather than a broad discussion.

Leveraging ICS' experience with a wide range of issuers, issues, and various engagement methods can help your company maximize your results and achieve your objectives.

The value of ISS Corporate Services in the shareholder engagement process:

Your ICS Advisor can work with your Board and Management team to provide a customized shareholder engagement plan and provide you with the information necessary to execute it effectively. To learn more about how we can help your firm, contact your **Advisor**.