Reaching out:

How companies can improve shareholder engagement

Shareholders have always had an interest in executive compensation. But, for over ten years, so-called 'Say-on-Pay' has greatly increased their involvement. At the same time, companies may face a struggle to engage them in the process of evaluating and ratifying compensation programmes. **Michael Brittian** and **Virginia Rhodes** of **Meridian Compensation Partners** explain how and why those companies should prioritise engagement.

Over the last decade, shareholders and proxy advisors have had a much greater say in executive compensation – the so-called 'Say-on-Pay' revolution – and companies have had to be clear and transparent. Even in the age of increased transparency and disclosure in the proxy, some shareholders demand more information and engagement while others are less responsive.

In some countries such as the UK, where Say-on-Pay has been binding for some time, this is a serious problem. In the US, however, shareholders are merely expressing a view on an executive compensation programme: so why should companies put time and money into reaching out to them?

"If it is not binding, then so what?", is a question that many companies ask themselves about Say-on-Pay voting. Virginia Rhodes of Meridian Compensation Partners notes that, "Investors want companies to increase transparency, engage in discussions and respond to their views. They want directors to be involved in the process and they want an opportunity to discuss areas of the programme where they see a disconnect with overall business strategy and/or company results. It is about giving shareholders a voice."

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"Over time, engagement has become more critical, especially for companies with less than 70% or 80% support," Rhodes adds. "When support drops below that level, it is clear that a significant number of investors are displeased with aspects of the programme design or outcomes. It becomes important in the year that follows for the compensation committee to demonstrate responsiveness and to show that they are concerned about shareholder views."

"Shareholders have always been interested in executive compensation, but Say-on-Pay has supercharged that interest," says Michael Brittian of Meridian Compensation Partners. "The notion of engagement is to have a dialogue, a rich discussion, so that the shareholder can find out more about the executive compensation programme and the compensation committee's recent decisions."

"Now, the importance has ramped up significantly," he continues. "For years, some companies got no vote or low votes, and they didn't know what to do about it. Now, there is a more established process and a set of expectations. Large institutional investors have put a lot of thought into their guidelines for executive compensation, so they have teams with governance expertise in place to have these conversations with companies."

It is during this engagement process where companies can take the opportunity to explain why executive compensation programmes are structured the way they are, why certain changes have been made and what they might be considering in response to concerns expressed. The process used for shareholder engagement is something that most companies disclose in their proxy statements on an ongoing basis (even in years where voting results are positive). However, in years where results soften, it becomes an even more critical step – particularly as it relates to appeasing the likes of Institutional Shareholder Services (ISS) and Glass Lewis – the two most prominent proxy advisory services in the US – which assist institutional investors with voting processes for the many companies in which they hold an interest.

Beyond compensation

Though executive compensation may be a key issue on which companies engage with shareholders, that is just one way of opening a door to a wider discussion and a deeper relationship. In the past, strong financial performance sometimes meant scrutiny from shareholders and other parties could be considered a minor issue. Now, shareholders and proxy advisers are focusing on a much broader range of issues – among them board governance, strategy, risk, CEO-succession planning, as well as compensation.

"Companies must show they have a philosophy for making executive pay decisions, and the compensation committee must be seen to be engaged in a comprehensive review process," argues Brittian. "Shareholders want to understand how the metric selection and the goal-setting process for compensation plans are tied to long-term shareholder value creation."

"Institutional investors support programmes that are tied to long-term business strategy, and they want to see that payouts are aligned to those strategies as they evolve," says Rhodes. "It is important for companies to ensure this link is evident through disclosure as well as discussed through the engagement process."

As a doorway to a wider relationship, any engagement on executive compensation must be well-structured and must go beyond the narrow scope of picking about the programme. "A big part of it is showing that a company knows what it is doing and why, so they must craft and prepare for that story," says Brittian. "It is important to think through the issues that are likely going to be discussed and craft responses in advance that relate to 'hot button' items or areas that may garner additional scrutiny. In addition, companies can also test changes under consideration with shareholders during the engagement process – to gain real time input and feedback. It is about bringing shareholders along."

"One of the times engagement is most critical is when performance is softening," adds Rhodes. "We've been in a bull market for a while but we are turning a corner. When there is a recession or performance softens, companies need to reassure uneasy investors who are concerned about long-term shareholder appreciation that pay programmes can be resilient."

But what if performance is strong and a company has good reviews from ISS and Glass Lewis? Why would investors, who have to talk to many companies and have limited resources, give their time if there is no direct concern?

"Just keep at it, keep reaching out," says Rhodes. "They are noting that you are contacting them, so when you need it the bridge is there. Historically, engagement has been about things other than executive compensation, so use those relationships, which should be nurtured over time, so that they are there if things turn south."

The tools of engagement

Persistence in reaching out is vital, but what about when the discussions happen? A company must ensure that it has the right team, perhaps including a director, who is willing to meet in-person to discuss any hot issues. There must be a clear list of talking points, on which all attendees should be prepped, and they must be able to show how they have learnt from and responded to investor feedback.

"We still work with clients that have had no engagement yet and we are educating them," says Brittian. "We help them to make a plan and build a team. Smaller and mid-market companies particularly need this."

"In the playbook, some steps are quite straightforward," adds Rhodes. "Start with large shareholders and request in-person meetings. Know who will be involved, make sure everyone is prepared, read proxy advisor reports for key issues, come with an agenda to guide the discussion rather than just responding to questions, and summarise what you have learned to show shareholders they have been heard."

The template is simple enough, but the messages that need to be shared are unique to each organisation. Filling in the detail is the hard part. "Shareholders often want conversations about other things, not just executive compensation, so you need to be ready to talk about other issues and have appropriate advice ready for those topics," notes Brittian.

Meridian can not only help design compensation programmes, but can also help companies prepare for those times when businesses have the ear of shareholders or proxy advisors. In those moments, investor relationships can be taken to the next level. ●

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