TAKING CONTROL

How Organizations Can Gain Governance Engagement

Written by Brendan Sheehan

Effective shareholder engagement has become one of the most important, and oft heard, mantras among corporate management and investors. Institutional investors are demanding – and expect – regular, proactive communication with company management and in many cases the board of directors. To put it simply, ongoing communication is one of the fundamental hallmarks of good governance.

We have seen several examples of how high-quality engagement can circumvent shareholder activism, defeat shareholder proposals and, perhaps most importantly, create long-term shareholder value. So with everyone looking to engage, many companies are examining their investor communication process and raising the question about who should be responsible for this important outreach and "own" the governance conversation. Traditionally the task has fallen to the investor relations office but as governance has become more important and more complicated, the corporate secretary is becoming more involved in the process.

In large part, governance engagement is being driven by the rise in shareholder activism. We are seeing more active engagement from investors of all varieties demanding greater insight into how the board functions, its role in strategy and oversight and its suitability as stewards of owners' investment dollars. This surge in activism has put board governance under the microscope and required a change in approach from corporate management. The range of topics being discussed has increased and is dominated by the most fundamental of board responsibilities – executive compensation and corporate performance. Proxy access, environmental and social issues (CSR) and risk management are replacing the more structural issues as the most important matters for consideration.

Governance is no longer limited to determining which items appear on the proxy statement and securing the vote. It is rapidly becoming a fundamental driver of investment decisions and an important strategic consideration. This is obvious from the now famous "Vanguard Letter" authored by CEO/Chairman William McNabb in 2015, "We believe that our active engagement demonstrates that passive investors don't need to be passive owners. Through engagement, we're able to put issues on the table for discussion that aren't on the proxy ballot. In essence, we continually strive to provide constructive input that will, in our view, better position companies to deliver sustainable value over the long term for all investors." This is supported by a 2015 study from Rivel Research Group of 374 institutional portfolio managers in which 88% say they believe corporate governance affects a company's valuation.

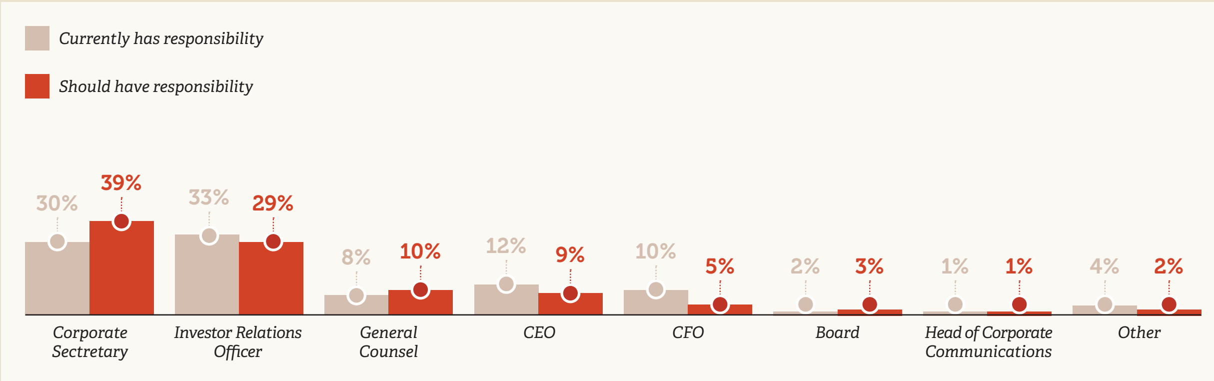
As such, companies are recognizing the need to present their governance story to all sides of the investment community – namely the special proxy analysts and the portfolio managers of their institutional holders. And that story needs to incorporate strategic and structural considerations.

In an attempt to shed some light on the role of the corporate secretary in engagement, Rivel Research Group reached out to corporate secretaries at 278 companies in North America. The findings are very revealing and highlight that while the corporate secretary is, for the most part, getting more involved, significant gaps in governance communication exist.

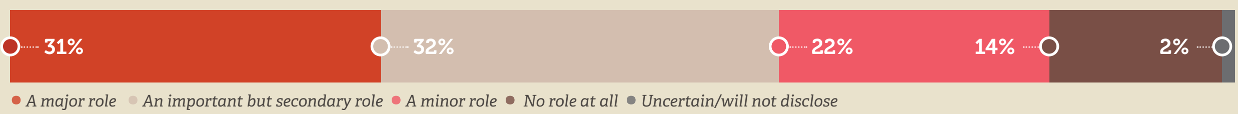
While most corporate secretaries (63%) acknowledge having a governance engagement role, their enthusiasm for direct engagement with investors on governance matters appears to be less than enthusiastic. According to the study, 39% of corporate secretaries believe they should be the primary point of contact with investors on governance topics. Interestingly exactly 50% also admitted that they do not want greater responsibility when it comes to governance communication with investors.

Facts & Figures

WHO *HAS* PRIMARY RESPONSIBILITY FOR CORPORATE GOVERNANCE COMMUNICATIONS WITH INVESTORS VERSUS WHO *SHOULD HAVE* THE RESPONSIBILITY



ROLE OF CORPORATE SECRETARIES IN COMMUNICATING/ENGAGING WITH INVESTMENT PROFESSIONALS ABOUT COMPANY'S CORPORATE GOVERNANCE PRACTICES



This a compelling issue considering that 72% also say that engagement is becoming a greater priority for their companies and 40% attest to receiving more governance-related questions from investors in the past 12 months. The degree and type of engagement are heavily dependent on the size of the company. Generally, corporate secretaries at the largest companies have much more direct contact with investors. This makes sense since these companies are generally in the spotlight more but also because the secretariat function is usually better staffed. There appears to be a significant resource problem for all but the largest companies. Only 17% of corporate secretaries speak directly with investors at least quarterly.

So while the corporate secretary is not exactly at the forefront of the conversation neither is the investor relations officer (IRO). Three-quarters of IROs say they discuss governance matters with investors but 63% said they would rather not. So with neither the IRO nor corporate secretary clamoring to lead the conversation, companies risk falling short of investor expectations and thus opening themselves up to misunderstandings and potential activist story telling.

It should be noted that the corporate secretary does "own" one very important aspect of communication – the proxy statement. Many investors highlight the written disclosures as among the most important vehicles for communication. Seventy-six percent of corporate secretaries have control in this area.

Perhaps the most important function of the corporate secretary is as an internal educator. Most board members and IROs view the secretary as the subject matter expert and the "first port of call" for all things governance.

With the increased focus on shareholder engagement, there is a clear opportunity for companies to extend outreach efforts. There is also a clear opportunity for corporate secretaries and IROs to present a more holistic and sophisticated view of corporate governance matters. It is likely this effort will require a shift in attitude from senior management and also a boost in resources, support and training for those involved in governance communications. As with most aspects of corporate life, functional ownership is important. Someone needs to be ultimately responsible and in many instances that someone will be the corporate secretary. It is worth noting that according to Rivel's 2015 IRO compensation study, IROs who engage regularly on governance matters get paid 17% more than their colleagues who don't.

As the governance conversation continues to evolve and as investors increasingly incorporate advanced governance considerations into investment decisions, it is vital that engagement focuses more on the corporate governance value proposition. Who is telling the company story and how does that story improve the understanding of the board in these volatile and complicated times?

Author Biography

*As Managing Director of Corporate Governance at Rivel Research Group, **Brendan Sheehan** provides Rivel's clients detailed insight into the minds of institutional investors. He works with the board and management to gain a sophisticated understanding of complex local and global governance issues and how they relate to voting and investment decisions.*