Stuart R. Levine on the Complexities of Modern Shareholder Communications

The 2008 financial crisis and resulting federal regulations have reinforced the primacy of public-company shareholders. Consequently, shareholders are demanding more information about company strategy, operations, directors, and governance principles in action. For boards, this creates the challenge of learning the composition of their shareholder base and effectively communicating how board actions reinforce and advance the value of the company. Stuart R. Levine, a director of Broadridge Financial Solutions and chair and CEO of Stuart Levine & Associates, spoke with *NACD Directorship* about current trends in shareholder communications. He provides his well-tested and proven advice for directors trying to navigate this increasingly complex area of governance.

From a director's perspective, how do you define meaningful and robust shareholder engagement?

I think everything that resides in the boardroom and in the culture of the board must focus on the shareholder—that relentless focus on the creation of long-term value. And so, questions around strategy and creating value really start with a focus by the board on the shareholder. This creates higher-level strategic discussions, because focusing on the shareholder moves conversation away from tactical discussions and gets the board focsued in the right direction.

The way you ensure a respectful relationship between shareholders and the board is by focusing on important forms of communication. For example, there's a powerful opportunity for respectful communications that add value in how a proxy is written and in how the candidates for election or re-election are submitted for a vote. It's important that those communications reflect activities that directors are involved in personally and professionally so that shareholders get a better sense of how their representatives are helping to ensure shareholder interests. We should be moving away from boilerplate and going to focused communication that gives shareholders better insights into the candidates.

We are on the eve of the 2016 proxy season. What should boards be doing right now in regard to shareholder outreach?

It's very easy to focus on institutional investors, but the reality is that if you look at the underlying accounts of brokerage firms, this year 32 percent of outstanding shares are actually held directly by retail investors. I think it's important to stimulate the discussion of reaching out to retail investors through communication and information that engages with those people, because one-third of your base is comprised of actual people—not entities or investment companies—that are investing and showing incredible faith in your service and in your company. It's the responsible thing to consider all of your total shareholders, not just the few that may initiate direct communications with you.

Are there differences between how the board reaches out to institutional investors and retail investors?

Because of technology, we have better tools out there today. For example, when you engage in a virtual shareholder meeting, an individual does not have to travel out of state to attend the meeting. A virtual meeting opens up the doors to all people, and potential investors as well. It gives people a chance to hear from the CEO about corporate governance and about the strategic direction of the corporation, all through an intelligent technology portal.

Shareholders want more and more data, but doing a data dump is not the most helpful way of presenting that information. How can directors approach creating meaningful communications that are on-point but also provide investors with the breadth of information they want?

I'm a great proponent of crisping up communication so people can have information presented in a clear way. When you talk about unloading volumes of data, it's interesting, but it doesn't get to the core issue, which is letting shareholders understand what your strategy is, the metrics behind those decisions, and how you're deploying capital, be it financial or intellectual.

Activist investors have become almost omnipresent. From a communications standpoint, how can directors anticipate and approach their engagement with activists, and what can they do to remain in touch with and represent the entire shareholder base?

At the end of the day, all directors have to look at themselves in the mirror. They need to define how the board is functioning, how the charter reflects the particular responsibilities of board members, and drill down on whether the right questions are being asked around strategy and the deployment of capital before an activist even comes in. We must be proactive in communicating the company's strategy and governance principles. Activist investors can be divided into two broad categories—those who want value now and those who have broader questions about your corporate governance. We shouldn't need the motivation of an activist banging on the door or acquiring shares of stock.

Each director has the responsibility to ask focused questions on strategy, succession planning, and deployment of capital. Those robust discussions are really important. When you hear other colleagues talk about activists, some people are threatened by them and not welcoming. Personally, I think activists are raising very important questions and some of them are incredibly effective in analyzing corporations and understanding how to add shareholder value. So before you start talking about activists, look internally and ask, "If I was an activist, what are the three or four questions I would be asking at this table?" When an activist comes through the door, they know if there's been a good strategic discussion—they can tell by the direction the company is taking. Every director has an obligation to ask intelligent questions and share intelligent strategic perspectives. And directors have to get past their fears.

You mentioned strategy. What general questions would you advise all directors to ask?

Strategy is based on many things, including changes and complexity in the regulatory world and in the world of the company's consumers and customers. Strategy is a subject that deserves to be on every board agenda and it's not a matter of doing one strategy retreat once a year. I think that those days should be over because a more hands-on approach is needed. When we talk about strategy, we talk about increasing volatility in the consumer's market and impact on brand. So for me, strategy is a living, very vital conversation and it's certainly not a one-off event—that's for sure. That's a big change. Directors can no longer fake it. The details matter.

What is the benefit of using technology in a shareholder communications program and are there pitfalls that directors may need to look out for?

Technology is a very cost-effective way to reach out to shareholders, number one. And shareholder communications are becoming far more efficient and data driven. From a strategic point of view, asking the CEO and the independent chair of the board how we're deploying technology to increase the strength of our relationship with our shareholder base is a really good question. Many of us now walk around with devices all day long, but most retail investors need to be reminded why it is in their best interest to vote. The more engagement, the better it is for the well-being of the corporation. I think developing programs on a regular basis that allow the company to share its strategy and results is critical, where appropriate.

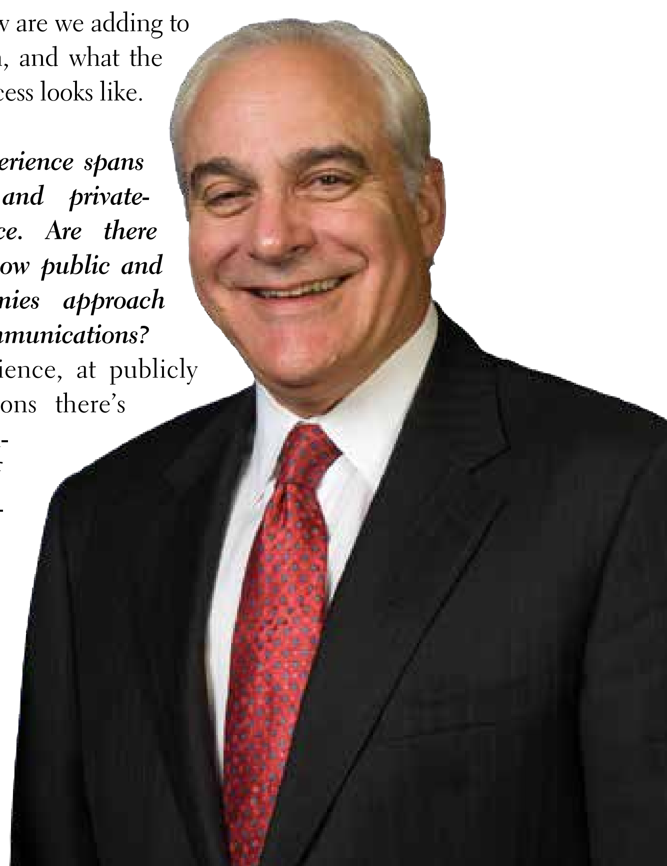
Another hot topic right now is the issue of proxy access, i.e., shareholder director nominations. What do you think boards need to be thinking about in terms of composition?

Board composition is a really important conversation because you cannot afford to have underperforming assets as board members. When you talk about board recruitment and retention, I strongly believe that the board should begin to reflect the company's customer base. For me, it's hard to believe that there still are large percentages of corporations that lack diversity. It's hard for me to understand how current demographics in this country—if not the world—are not represented at the board level.

This conversation needs to start with a robust discussion about criteria at the board level. Look to see, for example, if you have enough technology knowledge and strength on the board. And that becomes a good conversation, because, when you talk about shareholder value, you are making sure that you have somebody on that board or some "bodies" on the board that can add new insights and new experiences to the conversation. The resiliency of a board comes from a discussion of where is the world going, how are we adding to the conversation, and what the recruitment process looks like.

Your board experience spans both public- and private-company service. Are there differences in how public and private companies approach shareholder communications?

In my experience, at publicly listed corporations there's a greater understanding of regulatory realities, foreign corrupt practices, Dodd-Frank, and so forth. I think some of the smaller



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family-owned businesses are not as familiar with the implications of these issues because their shareholder meetings are considerably different than how we engage in the public sector.

Having said that, I think there should be a more robust engagement of family-owned businesses and private businesses to ensure that they are compliant with current regulations. For example, things like whistleblower protections and other relevant policies are leading indicators of the culture of an organization.

If management is not tracking whistleblowers in a private corporation and reporting that data to the board, they are missing an opportunity for that board to see how strong the company culture is around ethics and important compliance issues.

In your experience, what have been some of the biggest benefits of shareholder engagement?

The institutional shareholders study the corporation, they understand the balance sheet, and they're going to ask strenuous questions. That stimulates discussion in the boardroom and I think sometimes they bring ideas that really help move a discussion around new strategies, new technologies, and intelligent deployment of capital. As a director at Broadridge, I find those conversations really helpful; shareholders get deeper insight into how we view issues of compensation and fairness and so forth. And I think there's a good dialogue.

Corporations are better served when they hear from all of their shareholders including their retail investors. Directors have an obligation to talk to and encourage retail investors to vote their shares because the more that people engage, the more robust those conversations become, and the corporation functions better.

Is the In-Person Annual Meeting a Relic of the Past?

By Jonathan Foster

For most publicly-traded companies, the annual report used to be a detailed document printed on high-quality paper with first-class graphics and photographs describing a company's business and financial results. Today, it is often just a few pages attached to the Form 10-K required by the Securities and Exchange Commission. It's time that the in-person annual meeting is streamlined into a partially or even entirely electronic meeting.

Jonathan Foster

Although many companies incorporate in Delaware, all states require public companies to hold an annual shareholder meeting to elect the board of directors and transact other business that requires shareholder approval. Notice of the annual general meeting must be in writing and is subject to a minimum notice period that varies by state.

For decades, it was a legal requirement under Delaware corporate law to hold a live annual meeting. However, some corporations saw these meetings as a waste of time and effort, in part because attendance was generally very low, except for maybe large companies or companies that were under pressure from shareholders. About 15 years ago, Delaware, under pressure from these companies, decided that companies could hold meetings electronically—even by conference call.

Some companies host in-person annual meetings that are extravagant events. Berkshire Hathaway sets the standard for these corporate celebrations. This year's three-day celebration had numerous exhibits, a road race, various receptions and meals and, of course, the core annual meeting component where the highlight was several prominent journalists posing questions from shareholders to Warren Buffett and Charles Munger. Not even at this extravaganza did every shareholder question get answered. Wal-Mart has also elevated its annual meeting to the level of an "event." What do Will Smith, Taylor Swift, Ben Stiller, Miley Cyrus, Mariah Carey and Tom Cruise have in common? They have all participated in Wal-Mart's shareholder meetings, as the embattled retailer has deployed celebrities to improve its image. But unless you are a company of exceptional means, this model of "annual meeting as extravaganza" is hardly a realistic way to encourage shareholder attendance. And if anything, most companies are looking to curb costs wherever possible.

In 2001, Inforte Corp., a technology consulting firm, was the first company to host a virtual annual meeting. Before the meeting began, 97 percent of shares were voted via fax and the company was prepared to respond to shareholder questions transmitted electronically. Inforte kept with this format the following year and received few complaints. In 2002, another technology consulting company, Ciber Inc., held its meeting via webcast. According to then-CEO Mac Slingerland, no more than 10 people who weren't employees ever attended the in-person meeting, and he hoped that the new format would attract a larger portion of its 28,000 shareholders.

Last year, Hewlett-Packard Co. became the largest company to host a virtual annual meeting. It joined a growing number of companies foregoing ballrooms and conducting their meetings virtually.

According to Broadridge Financial Solutions, about 90 companies in the United States held entirely virtual annual meetings in 2015. There are a number of benefits to consider. First, shareholders who might not be able to attend a meeting in person due to their location or other factors are able to participate. Second, this format encourages shareholder participation by providing a secure platform on which to vote directly. Third, there is also a cost savings to be considered for both shareholders who can forgo travel, and the company, which is freed of meeting production and security costs. And finally, the environmental impact of hosting a meeting—from transportation-related fuel consumption to resources expended to create print materials for the meeting—is drastically reduced.

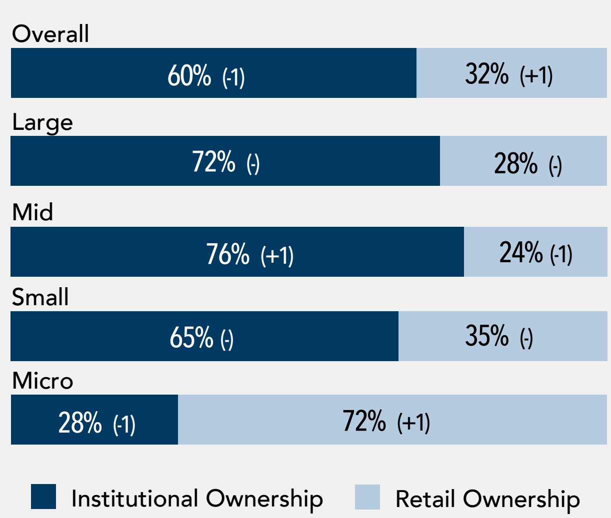
The annual meeting is no longer the primary place to air shareholder concerns, as the growing—and vocal—activist investor community has demonstrated. In fact, the Manhattan Institute this year issued a report concluding, among other things, that only three "corporate gadflies" were responsible for 70 percent of all shareholder proposals in 2014.

Some shareholders and their advocates assert that online-only meetings limit shareholders' face time with company executives and directors, hinder relationship building, and give companies greater control over the questions that are answered—specifically because they allow companies to guard against embarrassing protests or awk-

How the Numbers Add Up

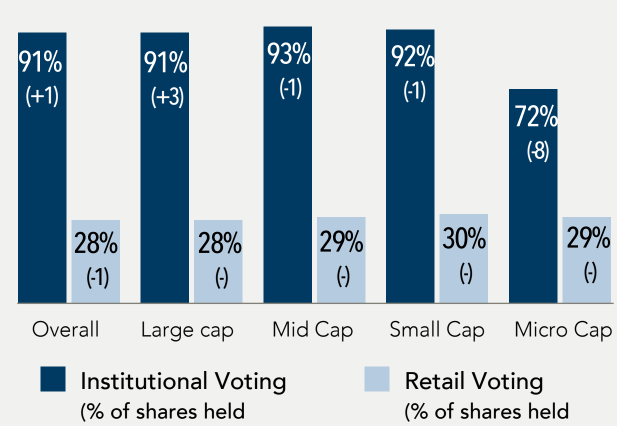
KNOW YOUR INVESTORS. Boards need to know how their shares are held. Although the initial inclination may be to focus on institutional investors, the ratio of institutional to retail investors can vary radically depending on the company's market capitalization. To look at both ends of the spectrum, while retail investors own 28 percent of shares in large-cap companies, they have a greater presence in micro-cap companies, holding 72 percent of shares.

Shares Ownership by Company Size
Proxy Season 2015



VOTING TRENDS. Although share ownership varies by market capitalization, institutional shareholders vote at higher rates. Furthermore, there has been a decline in the number of retail shares voted during proxy season: 28 percent of this segment's shares were voted in 2015, down from 31 percent in 2012. It remains to be seen how virtual or hybrid annual meetings, which ostensibly offer all shareholders greater opportunities to participate in a company's governance, will impact this trend.

Shares Voted by Company Size
Proxy Season 2015



+/- Indicates percentage point increase or decrease from proxy season 2014 ward face-offs between management and shareholders. This format also presumes that shareholders have an Internet connection and the necessary digital savvy to participate in these meetings.

These concerns are impacting how companies make digital access a component of the annual meeting. Several years ago, Procter & Gamble Co. amended its bylaws to allow virtual meetings, only to backtrack following objections from shareholders. After Symantec Corp. hosted an online-only meeting in 2010 and heard complaints, it compromised by switching to a hybrid format where a physical event is held but investors can also "attend" online. Intel Corp. and Microsoft Corp. have followed suit.

Here are a few suggestions to make virtual meetings inclusive and productive:

- Establish procedures for shareholders to vote remotely.
- Establish guidelines for handling questions from shareholders who are participating electronically, specifically with regard to posting questions before, during, and after the meeting.
- Archive and post the meeting to a location that can be readily accessed by shareholders.

Stringent disclosure requirements, extensive media outlets, and a vocal activist community make the in-person annual meeting feel outdated. Do concerned shareholders wait for the annual meeting to ask hard questions or air their grievances? A virtual or hybrid meeting should satisfy the intent of the annual meeting and can be of greater benefit to both companies and shareholders. D

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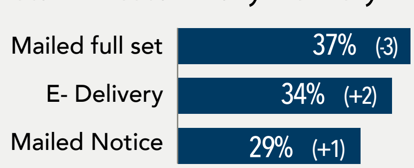
STRATEGIC COMMUNICATIONS. With knowledge of the composition of the shareholder base and how they vote, companies must then develop a communications strategy that will be impactful. Considering the variety of shareholders and their voting habits, a one-size-fits-all approach is not effective in many solicitations. A combination of targeted messaging, customized packaging, and providing multichannel experiences, which demonstrates that the company understands its shareholders, do more to encourage participation. Technology is impacting how companies engage with shareholders and directors need to consider how digital messaging can be used in communication efforts. Looking at data from the 2015 proxy season, electronic delivery of proxy materials to retail investors rose by 2 percent, while mailed materials dropped by 3 percent.

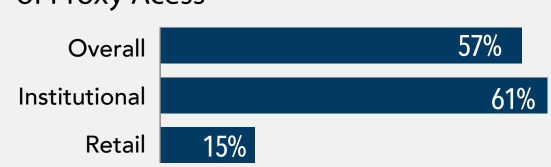
Retail Investor Proxy Delivery Methods



(-) Indicates no change year over year. Source: *Proxy Pulse*

POWER TO THE PEOPLE. The battle for proxy access is gaining momentum, however, not all shareholder are fighting to influence board composition. Looking at the 2015 proxy season data, 85 percent of votes cast by retail shareholders opposed proxy access proposals, while 61 percent of votes cast by institutional shareholders were cast in favor of such proposals. Broadridge anticipates that by the end of 2015, more than 100 proposals for proxy access will come to a vote.

Percentage of Shares Voted in Support of Proxy Acess



ProxyPulse is a collaboration between Broadridge and PwC's Center for Board Governance. The analysis is based upon Broadridge's processing of shares held in the name of a brokerage firm, which accounts for over 80 percent of all shares outstanding of U.S. publicly-listed companies. Shareholder voting trends during the proxy season represent a snapshot in time and may not be predictive of full-year results. For purposes of this report, the term "institutional shareholders" refers to mutual funds, public and private pension funds, hedge funds, investment managers, most managed accounts and vote agents. The term "retail shareholders" refers to individuals whose shares are held beneficially in brokerage accounts. Visit www.proxypulse.com for more information.