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Establishing relationships

Designing and executing an effective proxy solicitation strategy is an important process

In an era of shareholder activism and increasing investor engagement, it is more important than ever for boards to have effective strategies for identifying their shareholders, understanding how they think and behave and designing thoughtful campaigns to effectively communicate with them.

While traditional proxy solicitation campaigns will remain an important part of an overall strategy, the engagement process starts much earlier and has become more sophisticated.

Annual meetings, special elections and mergers and acquisitions (M&A) transactions are now much more than simple get-out-the-vote efforts. Companies are facing increasing proposals and public pressure from shareholders for spin-offs and other actions; reworked compensation packages and transactions are being challenged. Size no longer seems to matter, either. In a 24-hour period in December, three of America's biggest companies – Yahoo!, DuPont and Dow Chemical – made major corporate strategy changes after coming under pressure from activist investors.

Shareholder activism has reached record levels both in the US and Europe with assets under management at activist hedge funds reaching more than $160billion in 2015 and newcomers entering the field. According to Activist Insight, more than 40 per cent of activists that launched campaigns in 2015 had no recorded history of activism as far back as 2010. Institutional investors are increasingly voting for directors put forward by activists and they are allocating capital to hedge funds with activist strategies.

Against this backdrop, a board of directors needs to implement a strategy of ongoing dialogue with their shareholders, focussed on clearly articulating the company's long-term vision and plans to create value. Activism is no longer just the focus of a few hedge funds. Shareholder engagement has become a broader and more encompassing phenomenon that affects every investor, company and market participant. Boards are more involved with shareholders than ever before and designing an effective solicitation and outreach strategy is one of the most important things boards can do to remain successful in this environment. Here are the key elements.

Identifying and understanding your shareholder base

The starting point for any proxy solicitation campaign involves identifying a company's shareholders and understanding how they think and behave. Without properly understanding your shareholder base and their historical voting patterns, an outreach and investor response campaign is likely to be fruitless.

This process is part art, part science and part elbow grease. It involves not only examining past voting records and public information on institutional investment managers' holdings, but also understanding the profiles of multiple custodians and the various accounts within their custody. In the US, this can be done via the Depository Trust Company (DTC). Monitoring options flow, short interest and canvassing the hedge fund universe to determine who is trading in the stock are all part of the identification process. Relying solely on public filings can give a grossly distorted picture of a company's shareholder composition. Most public filings are only made available once a quarter and typically have a 45-day lag before they are published.

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What's more, most banks and brokers no longer provide shareholder identification information and institutional investors will no longer provide their holdings outside of public filings. Knowing what to look for in custodial accounts and understanding who are the underlying shareholders become integral to any campaign.

Different types of investors from actively managed mutual funds to index funds, quant hedge funds, arbitrage funds, retail investors, activists and pension funds, all think and behave differently. Each type of shareholder has different priorities that are manifested in how they vote in elections (both contested and uncontested) and how much they rely on the advice of proxy advisors, such as ISS and Glass Lewis. Understanding who the key decisions makers are, and how they have voted historically, will shape any effective outreach campaign.

Identifying your proposals

Whether your proposals are 'routine' or 'non-routine' under NYSE Rule 452 matters greatly to how a campaign is constructed. Many brokers still exercise discretionary voting authority in routine elections, meaning they can vote any unvoted shares on behalf of their clients. Brokers do not have discretion over unvoted client shares on 'non-routine' proposals, which now include most corporate governance proposals such as splitting the role of chairman and CEO as well as contested elections.

Evaluating the solicitation process and alternatives

Once you've accurately identified your shareholder base and the type of proposals shareholders will be voting on, you need to map out a detailed and comprehensive outreach and communications strategy and set the appropriate record and meetings dates (these dates matter). The key is planning ahead for different scenarios. So, an effective strategy involves creating multiple vote projections for each proposal and segmenting those vote projections and response scenarios for different types of stockholders, such as institutional and retail.

The communication and solicitation strategy also needs to be specifically tailored for different shareholders, based on how that group thinks and behaves. It's also extremely important to plan out how you are going to communicate with Institutional Shareholder Services (ISS) and Glass Lewis. Understanding what the proxy advisory firms care about and how they like to communicate (who to bring to the initial meeting, for example) is extremely important.

Solicitation

Once the plan is in place, it's time to execute. It's no secret that the process of proxy solicitation is difficult and has changed dramatically over the years. Solicitation needs to be done in a thoughtful and comprehensive way, with an understanding of what influences all types of stakeholders and how they like to go about voting.

Reviewing proxy materials, preparing institutional shareholder lists, communicating with proxy advisors, Broadridge, analysts, brokers and banks all needs to happen quickly and seamlessly. Each campaign needs to be tailored to the specific shareholder base. If retail shareholders make up a large portion of the base, a company needs to have a plan in place to reach these typically apathetic voters and make sure they have the chance to vote.

Once voting has commenced, the situation becomes very fluid and the final step in any solicitation process is diligently monitoring the progress of actual voting all the way through the polls closing at the meeting. It is not uncommon for unanticipated speed bumps to appear along the way. How you respond is crucial. Is the vote continuing to track to your vote projection? Do you have a contingency plan ready if it is not? If it's a contested election and there are settlement talks ongoing, understanding who is voted and who is not and what the potential and likely outcomes are is crucial. Be prepared to move quickly and communicate effectively so shareholders and other stakeholders know what's going on. Make sure that votes are counted and there is constant communication with the inspector of elections to ensure votes are being properly processed.

Whatever the outcome of a solicitation campaign or a contested election, there needs to be a plan in place to communicate the results in a way that reassures shareholders that the company is committed to long-term value creation. In the age of shareholder activism, proxy solicitation campaigns are no longer what they used to be. Some companies have successfully adapted to the changing landscape, but the majority have not. Communication, on-the-ground intelligence and shareholder understanding is vitally important, not only to a particular campaign, but to ensuring solid long-term relationships with your shareholders.

VYING FOR VOTES
An outreach and investor response campaign is key to staying ahead