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Governance expectations for 2023

By Alexandra Higgins, managing director, Okapi Partners

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The immense challenges companies and their shareholders have faced in recent years are likely to remain with us in 2023. Having recently emerged from the pandemic, companies face a bleak global economic outlook, overshadowed by inflation and the impact of Russia's invasion of Ukraine. Add to that mix rising shareholder activism and shifting regulations. In short, boards and management will be tested in their abilities to both manage risks and create new opportunities.

Given this backdrop, it is worth exploring how boards can prepare for 2023 and beyond. We see two main trends boards should pay attention to for the upcoming proxy season: a likely surge in contested situations and a greater focus on ESG disclosure.

A likely surge in activist situations

Shareholder activism tends to bloom in times of economic crisis. Uncertainty over asset values combined with market volatility can make some companies more vulnerable than others. As with the last recession, we are likely to see activists target companies that appear unprepared for a possible recession or those that are already suffering the effects of inflationary pressures and supply-chain disruptions.

The arrival of the SEC's universal proxy rules will not necessarily make it easier for activists to launch a contested campaign, but it will place greater scrutiny on individual director performance.

Under the previous rules, specific directors were targeted by dissidents for replacement. Now, all directors could become so-called targets. This scrutiny will be exacerbated by external third parties like Boardroom Alpha that are rating individual directors on an A-F scale.

Activism preparedness should become a regular part of board agendas as directors consider the risks and opportunities related to upcoming challenges. Preparedness begins with a strong team of advisers who have experience in activism defense, an assessment of vulnerabilities (including ESG vulnerabilities) and a credible strategic response to potential activist demands.

It will be important for boards to understand the risks each director would face in a proxy fight, where the company's strategy may be questioned and how media will play a larger role in contested campaigns in the future.

A greater focus on ESG disclosure

As investors and companies continue to look to incorporate ESG considerations into their practices, their need for standardized ESG reporting has become a priority. Investors and companies have coalesced around specific ESG frameworks and reporting to achieve standardization.

A top priority for investors right now is board oversight of climate risk. The TCFD has become the most supported framework for climate risk disclosures and certain investors have incorporated TCFD standards into their proxy voting guidelines.

For example, BlackRock has started voting against directors at certain companies that have not disclosed information under TCFD or have not disclosed Scope 1 and Scope 2 greenhouse gas emissions with meaningful targets.

Another major focus for investors has been board oversight of human capital management. Some investors such as State Street started voting against directors at certain companies that do not disclose their EEO-1 reports, which contain demographic workforce data, including data by race, ethnicity, gender and job categories.

During engagement with companies, many investors have been asking questions related to employee turnover, recruitment and retention efforts and programs for advancement, especially for employees of racial or ethnic diversity.

We believe the next big area of focus in ESG will be disclosure of metrics related to natural resources, particularly around water scarcity. BlackRock and other large investors are members of the Taskforce for Nature-Related Financial Disclosure, a framework similar to TCFD except that it focuses on nature-related financial risks.

Board qualifications under scrutiny

With activists targeting incumbent board members, and investor expectations around ESG and diversity, equity and inclusion performance running high, we believe there will be a larger overall focus on board composition and skills.

Investors will increasingly question whether directors have experience relevant to issues like sustainability and cyber-security, and whether the board has a sufficiently diverse composition and perspective. As challenges proliferate in the coming year, companies will need to show they have the right people on board to deal with those challenges.

About Okapi Partners

Okapi Partners is a full-service proxy solicitation and investor response firm that prides itself on having unrivaled insight into how investors think and behave. We design and execute thoughtful, results-oriented strategies that ensure our clients succeed in any scenario requiring an investor response, including director elections, proxy contests, M&A transactions, annual meetings, governance and compensation issues and tender offers.

Okapi has advised corporate clients of all sizes, hedge funds, mutual funds, closed-end funds, private equity firms and leading activist investors. We offer clients superior intellectual capital, extensive industry relationships and unmatched execution capabilities.

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