GETTING BACK TO BUSINESS

Key issues driving investors and how they want to engage

Shareholder engagement refers to the ongoing structured and informal interaction of institutional and retail shareholders with a company throughout the year, as well as in the period leading up to, and at, the annual general meeting (AGM). The diversity of shareholder interests, expectations and timeframes for holding shares, can present significant challenges for Boards of Directors and management, including how to tailor their way of dealing with different shareholders throughout the year, not just before and at the AGM. This continuing engagement may assist and encourage more informed involvement by shareholders in matters pertaining to the company in which they have invested, with the AGM remaining as one means for shareholders to hold the Board publicly accountable.

In the past, engagement with a company's largest shareholders was generally led by key management, however, this has radically evolved in the Australian market following a significant increase in the shareholdings of investors who are considered passive. These passive investors include index funds, pension funds, sovereign wealth funds and state sector funds who have a particular focus on environmental, social and governance (ESG) related issues. In addition, many active investors now incorporate ESG into their investment decision making process, and therefore wish to engage on these topics.

ESG-focused investors are generally most interested in engaging with the Board of Directors who they believe are accountable for 'non-financial' risk management and seek to hold them accountable when exercising their vote on director election resolutions. Engagement is now also much broader and includes other stakeholders such as proxy advisors, ESG research firms and activist shareholder groups.

The approach of both management and Directors playing a role in engagement allows companies to better communicate their long-term strategy from different perspectives, while also strengthening investor relationships. Additionally, engagement from Directors can be an effective way to help investors better understand how the company manages risks and opportunities, maintains positive culture, and thinks about its future impact.

Deciding on the timing and who is involved in the engagement process ultimately comes down to companies understanding the identity of their investors from an asset manager and asset owner perspective, their expectations, influencers, needs and concerns. Another important consideration is the cadence of engagement, making sure that this process is happening both 'within and out of cycle' all year round to strengthen relationships and build trust, rather than it occurring only in the lead up to a company's AGM.

When done right, this understanding coupled with a tailored engagement approach that has the right people in the room, helps achieve informed engagement, a positive impact on shareholder voting, investment decisions, and a company's overall reputation in the market.

What topics are asset owners and investors focused on?

ESG issues continue to gather momentum on the engagement agenda as asset owners, fund managers and the general public increasingly focus on sustainability as a core concern. Compulsory superannuation has exposed every working Australian to ownership in listed companies, and individual superannuation fund members, along with investment managers, want to know their contributions are being responsibly invested for the future.

Climate change and related risks have emerged as the predominant ESG topics, particularly following Australia's recent and unprecedented bushfire season which had a devasting impact on the environment, property and people. Additionally, culture is increasingly being raised during these engagements, with Directors expected to have a coherent understanding of how their company instils and manages culture and how it can be described.

Most recently, there has been renewed focus on risk management and Board preparedness in a post pandemic world with COVID-19 exposing gaps in the scenario planning of many companies. While the widespread impact of coronavirus was unforeseen by most, these impacts have had to be monitored in a real time and granular fashion over recent weeks, and will undoubtedly change the scope of likely scenarios companies consider in relation to their supply chains, customers and employees well into the future.

How has engagement changed in 2020?

In addition to risk management and Board preparedness, engagement in 2020 will continue to focus on how companies are integrating and reporting ESG issues relating to their businesses, and an expectation from large funds that companies report under the TCFD framework.

Investors who took part in Morrow Sodali's 2020 Institutional Investor Survey, published in March this year, were overwhelmingly united in their responses that proactive and regular engagement with both management and the board, 95% and 86% respectively, informs their evaluation of a company's corporate purpose and corporate culture.

Additional survey findings included 81% of respondents agreeing that a company's stakeholder engagement approach and outcomes should be included in disclosure when they explain their corporate purpose. Among key topics, 91% ranked climate change as their main topic of engagement with boards, followed by human capital management which was cited by 64% of investors.

What this tells us is that deeper disclosure is expected by investors around board skills, culture and other non-financials as companies in Australia transition to adopt the 4th Edition of the ASX Corporate Governance Principles and Recommendations which take effect this year.

Investors will want to better understand investment risks and opportunities in terms of how companies are performing across both financial and ESG measures and whether they should be exiting from investments, where that is an option.

The quality of disclosure around ESG, and extent to which it assists investors in their decision-making process will shape engagement for the year ahead.

Further insights from our 2020 Institutional Investor Survey are covered on page 6 of this edition of Lighthouse.

Suggestions for companies looking to undertake successful engagement in 2020 include:

- Ensure that there is an opportunity for the Board and Chair and other Directors to build relationships with top investors.
- Develop a slide deck focused on specific issues to help better guide your meetings.
- Take the initiative to control the messaging about what is being done around ESG, risk management and Board preparedness.
- Engage with investors 'out-of-cycle' from your reporting period to discuss updates and provide sustained engagement throughout the year.
- Be prepared to acknowledge and address concerns raised from the previous AGM.