Teneo®

The Global CEO Advisory Firm

Teneo Insights

Stakeholder Capitalism's First Test: Top 10 Questions Companies Should Expect from Shareholders This Proxy Season and Beyond

By Martha Carter, Matt Filosa, Sean Quinn, Sydney Carlock and Jennifer Walmsley

March 2020

Health and safety are obviously the world's top priorities right now. A number of companies are taking bold action to help mitigate the extraordinary global impacts of the coronavirus crisis. But unlike prior crises, companies are navigating this one within the context of "stakeholder capitalism" – an investment philosophy asserting that the best way to create and preserve long-term value is to consider the interests of all stakeholders (including employees and the environment). As investors continue their focus on sustainability issues and companies navigate the proxy season with virtual shareholder meetings, it's critical that companies prepare for some difficult questions from the investor community.

Over the past year, stakeholder capitalism has been broadly endorsed by major companies and investors from around the world. Last year, over 180 public company CEOs signed a revised Business Roundtable corporate purpose statement outlining a fundamental commitment to all stakeholders. Earlier this year, BlackRock also emphasized this "fundamental reshaping of finance" in its annual letter to CEOs. **This crisis will not only result in a continuance of the stakeholder capitalism movement, but an acceleration of it.** Politicians have already been pressuring companies on their response to the crisis in the context of stakeholder capitalism, and the investment community is beginning to do the same. Some examples include:

- BlackRock recently commented it would not be easing up on its sustainability priorities this proxy season, including a mandate that companies disclose to the SASB and TCFD frameworks by year end.
- A group of over 200 institutional investors published a set of expectations of all companies during the coronavirus crisis, including fair treatment of employees and limits on executive compensation.
- US proxy advisor Glass Lewis recently advised that all governance issues will be impacted, indicating that there is no better way to observe the effectiveness of governance than in a crisis.
- UK proxy advisor PIRC urged boards to restrict executive pay to base salary only.
- JUST Capital announced a Coronavirus Corporate Response Tracker - a rating of how well companies are managing their stakeholders throughout this crisis.

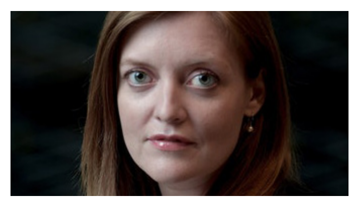
But what exactly are investors expecting of companies and boards during this crisis? Below is a sample of questions that companies will likely receive from governance teams, ESG teams, proxy advisory firms, ESG ratings firms and others during the 2020 proxy season and beyond.

1. What has been the Board's role throughout this crisis?
Many large investors have already clearly expressed that they consider boards directly accountable for overseeing sustainability issues,

Martha Carter
Vice Chairman & Head of Governance Advisory
martha.carter@teneo.com

Matt Filosa
Managing Director
matt.filosa@teneo.com

Sean Quinn
Managing Director
sean.quinn@teneo.com



Sydney Carlock
Senior Vice President
sydney.carlock@teneo.com

Jennifer Walmsley
Managing Director
Jennifer.Walmsley@teneo.com

such as oversight of human capital management, corporate culture and CEO succession planning. As such, boards should be actively involved in the company's crisis response and be prepared to engage with shareholders on the topic. For example, has the board been involved in any decisions relating to employees? How is the board planning succession for itself and senior leaders – not only in case of illness but as a core element of a board's work? **It is not inconceivable that some investors will hold directors accountable for these issues as soon as this proxy season, if there are signs of ineffective oversight.**

2. Has the crisis caused the board to review its overall composition?

Investors have been advocating for boards to ensure they have the proper skillset to manage the company for the long-term, including those skills relating to risk and crisis management. Investors could ask whether a board was properly equipped to help the company manage itself through this crisis. Boards should be ready for questions about how the board's current composition is reflected in its ability to oversee the company's response to this crisis, and whether it has caused them to rethink its composition in any way.

3. How has/will both short and long-term executive pay be impacted by this crisis?

The financial crisis of 2008 materially changed the way executives were paid far beyond the banking sector, including linking executive pay more closely to performance measures and eliminating certain pay components such as tax gross-ups. The next wave of executive compensation reform will likely be focused on another material change - linking executive pay more directly to sustainability issues such as worker safety, environmental goals and/or employee satisfaction. Any decisions by the board's compensation committee, such as adjustments to short-term incentive metrics or retention grants, should have a solid and disclosed rationale that aligns with the company's long-term strategy. Executive compensation actions at companies that implemented broad-based employee layoffs, furloughs, or pay cuts will be subject to an additional layer of scrutiny. Many companies are, with good reason, taking a wait-and-see approach before making adjustments to executive pay. However, even though Say On Pay is a retrospective view, **it is not inconceivable that some shareholders will vote against Say on Pay this proxy season for recent pay decisions that are deemed egregious.**

4. How has the company managed employee issues throughout this crisis?

Human capital management has been at the forefront of investor sustainability initiatives in recent years. Investors will want to know how the company is managing its workforce throughout the crisis, such as how they are maintaining jobs, providing paid leave, and prioritizing employee health and safety. Investors are likely to inquire which key performance metrics the company utilizes to measure its human capital management strategy. Clear messaging about a company's management of employees will be important.

5. Has the crisis had any impact on the company's ability to fulfill its commitments to the environment?

Prior to the crisis, many companies established robust goals on how to combat the increasing risk of climate change, such as reducing its own carbon emissions and/or better managing its water and waste. Investors will likely inquire whether the crisis has resulted in any adjustment to those goals or whether those goals are still on track for completion. Companies should be monitoring whether the current crisis is impacting any of its disclosed sustainability goals.

6. How has the crisis impacted the company's capital allocation strategy?

Stock buybacks have come under increased scrutiny during this crisis from many stakeholders, including some investors. Companies will be expected to express how this crisis has impacted capital allocation strategies with a goal to encourage greater balance sheet flexibility and long-term planning.

7. Will the company increase its disclosures relating to sustainability issues as a result of the crisis?
Investors will likely continue their demand for increased disclosures on the aforementioned issues in future proxy statements and sustainability reports. Any decisions made in the context of this crisis will need to be properly disclosed in order for investors, proxy advisors and ESG ratings firms to consider them as part of their analysis. A company that does not have a robust sustainability report should benchmark its current disclosure with best-in-class peers to ensure it is at least aware of any gaps.

8. Has the company continued its shareholder outreach programs throughout this crisis?
This crisis is coinciding with an important time for investor governance teams – proxy season. While some investors have provided a small bit of relief for companies about specific proxy issues (e.g. virtual shareholder meetings – see Teneo piece here), investors still want to be heard. So, it is important that companies effectively manage shareholder two-way dialogue in their virtual meetings and continue their shareholder outreach programs (either during or post-crisis) to ensure that they understand their shareholders' priorities.

9. What are the company's plans going forward? Will you adopt a poison pill?
Many investors market themselves as "permanent capital" and will be almost exclusively focused on the long-term. There will be of course some appreciation for the immediate needs of the company given the current crisis, but they will likely expect all decisions to be consistent with sustainable, long-term growth. For example, any company that adopts a poison pill will need to clearly articulate why this in the company's long-term interest and ensure the features are aligned with its rationale and best practices on pill adoption.

10. Has the company's ESG ratings been impacted by the crisis?
ESG ratings are increasingly impacting investment and voting decisions. The methodologies of the primary ESG ratings firms incorporate all of the issues contemplated above – board oversight/composition, executive compensation, environmental commitments, shareholder engagement, and disclosure. Methodologies also typically include a "controversies" assessment – attempts to identify when a company may have mismanaged a specific situation relating to crises or otherwise. ESG ratings firms have been updating company ESG ratings much more frequently than in prior years, and we expect the crisis to trigger even more frequent updates. It is important for companies to track and analyze any changes to their ESG ratings.

The 2008 financial crisis arguably caused the onset of the stakeholder capitalism movement. This crisis, while different, will only continue to accelerate stakeholder views as investors begin to separate the outperformers from the underperformers. As such, it is critical that companies consider the implications of stakeholder capitalism on both its actions and its messaging to investors. This crisis underscores the importance of considering the interests of stakeholders in both short- and long-term planning and decision-making. Companies should prioritize preparing for difficult questions from governance teams, investment teams, proxy advisory firms and ESG ratings firms.

Teneo will continue to closely monitor the implications of the crisis and expectations of investors, ESG ratings firms, and other stakeholders during the current proxy season, as well as looking forward to 2021.

Please reach out to martha.carter@teneo.com or matt.filosa@teneo.com with questions or to discuss this content further.

Teneo

Teneo is the global CEO advisory firm.

Working exclusively with the CEOs and senior executives of the world's leading companies, Teneo provides strategic counsel across their full range of key objectives and issues. Our clients include a significant number of the Fortune 100 and FTSE 100, as well as other global corporations.

Integrating the disciplines of strategic communications, investor relations, digital advisory, diversity & inclusion, management consulting, physical & cyber risk advisory, financial advisory, corporate governance advisory, political risk advisory, and talent advisory, Teneo solves for the most complex business challenges and opportunities.

teneo.com