Beyond COVID-19: Taking the Long View

Board & Investor Perspectives

While the ongoing coronavirus pandemic continues to necessitate that companies undertake short-term actions in support of their financial stability and resiliency, with the passage of time, both boards and investors are increasingly focused on potential longer term impacts of the crisis and the long-term implications of current day decision-making, as illustrated by these recent perspectives.

Long-Termism: Here's How!

Based on extensive research, including director survey data: "Tone at the Top: The Board's Impact on Long-term Value"* from FCLTGlobal and Russell Reynolds suggests tangible ways in which the board can foster a long-term orientation, including action items that may be positively influenced by the corporate secretary such as board agendas, board materials, meeting documentation, messaging, and follow-up. The focus is on properly balancing short-term and long-term issues, with an emphasis on framing short-term issues in the context of the company's long-term performance.

The instructive publication includes a director "cheat sheet" with these (and other) sound action items:

A well-functioning corporate board of directors—one that is aligned on time horizons and communicates clearly with management—wields the power to meaningfully influence the purpose, culture and direction of the organization.

- Use clear language during discussions to emphasize that the primary focus is on the long term
- Craft boards agendas to include items that are focused on long-term issues
- Regularly review past agendas and meeting minutes to confirm time is being spent as intended
- Provide explicit guidance to management to be long-term oriented
- Ensure directors are not sending mixed messages to executives via other means
- Explicitly link executive compensation to long-term value creation
- Examine all of the key performance criteria and metrics to ensure they do not inadvertently encourage a focus on the short term
- Align compensation to long-term value creation for the board, not just management
- Compensate board members primarily in stock and consider locking up stock awards through or beyond the term of service
- Develop a board statement of purpose that emphasizes long-term interests

Notably, the research shows how the views of long-term-oriented and short-term oriented directors differ as respects their motivations to serve on a board and their focus in the boardroom such that companies are encouraged to address potential short-termism in the candidate recruitment process. Along those lines, the paper identifies short-termer "red flags" and suggests how the board's nominating/governance committee can pick up on these indicators in the candidate diligence and vetting processes.

* "Tone at the Top: The Board's Impact on Long-term Value" available at https://higherlogicdownload.s3.amazonaws.com/GOVERNANCEPROFESSIONALS/a8892c7c-6297-4149-b9fc-378577d0b150/UploadedImages/Tone-at-the-Top-The-Boards-Impact-on-Long-term-Value.pdf

Corporate Purpose: Investors Speak

SquareWell Partners' January/February 2020 online survey of investors worldwide collectively managing approximately $22.1 trillion in assets elicited* some surprising and some not-so-surprising views on the relevance of corporate purpose, who should be responsible for delivering it, and how it should be measured and accounted for. Survey respondents were from Stewardship (70%) and Responsible Investment teams (30%). London Business School Professor of Finance Alex Edmans and Wachtell Lipton Partner Sabastian Niles prepared the report's Forward and Concluding Thoughts, respectively.

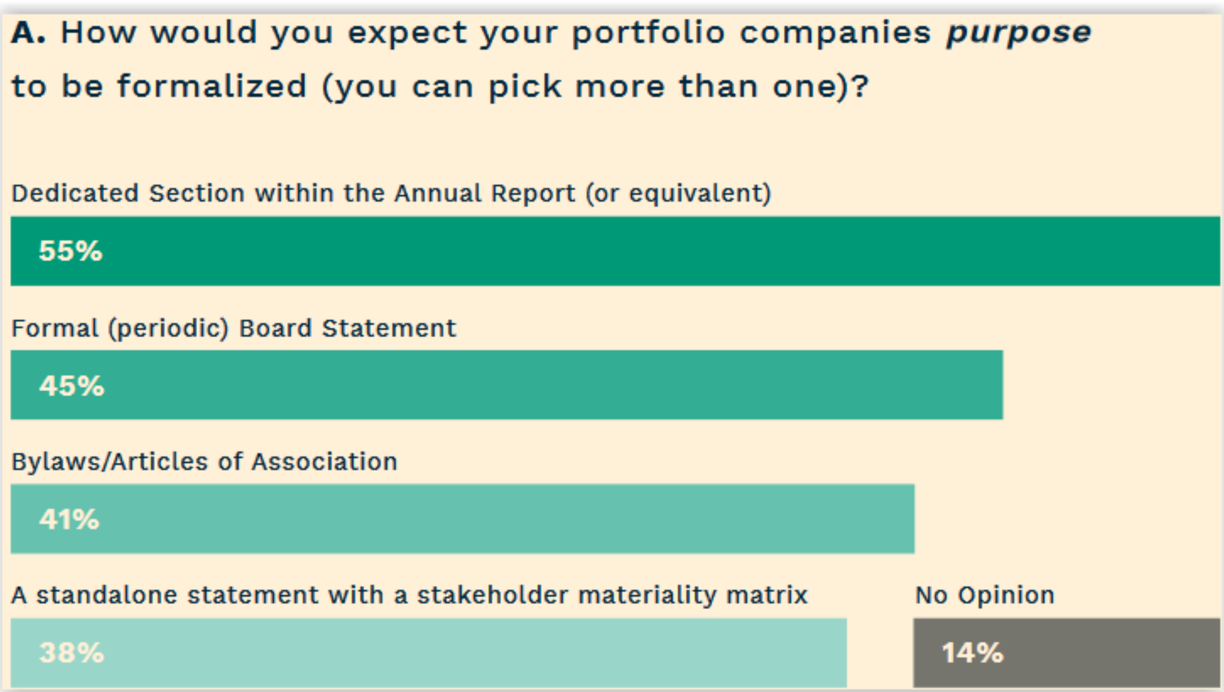
Key takeaways include:

Relevance

- 76% of respondents expect companies to have defined their purpose; 14% do not; and 10% have no opinion.
- Investors most commonly think that defining corporate purpose is important because it is needed to set a long-term business strategy that creates value (93%) or strengthen corporate culture (76%).
- 76% of respondents say that the corporate purpose should drive company strategy; 52% expect the purpose to be aligned with the UN SDGs.

Setting, Implementation & Disclosure

- An overwhelming 93% of respondents identify the board as responsible for defining the company's purpose compared to just 55% that identify the senior management team (including the CEO) as having this responsibility; however, investors identified the management team and the board as equally responsible for implementation.
- 55% of respondents expect the corporate purpose to be formalized in a dedicated section within the annual report (or equivalent); however, a formal periodic board (not CEO) statement was also identified as an acceptable vehicle by 45%. Other answer choices also garnered some support, as shown here:



- 86% of investors would expect to see written statements regarding the fulfillment of the company’s purpose by the entity responsible for setting it.

Accountability

- 64% say they are engaging with companies on their purpose.
- A minority of investors (34%) would want to have a say/vote on a company's purpose; 42% said they would not, and an additional 24% had no opinion.
- Investors most commonly would evaluate these factors to determine whether a company's purpose is effective: consistent disclosure regarding its implementation, stakeholder concerns (lack of), employee satisfaction/turnover, and financial performance relative to peers.

- Investors would most commonly consider a discharge (of the board or CEO, presumably) if they were not satisfied with the company's purpose or its implementation. Short of that, 38% would consider voting against the board chair, and 24% said this would not drive any negative vote.

As is always the case in evaluating survey results, readers should carefully consider any inherent biases associated with the questions asked and the response choices, which - in this survey - did not allow for free-form "Other" responses. Many questions allowed respondents to select more than one answer choice.

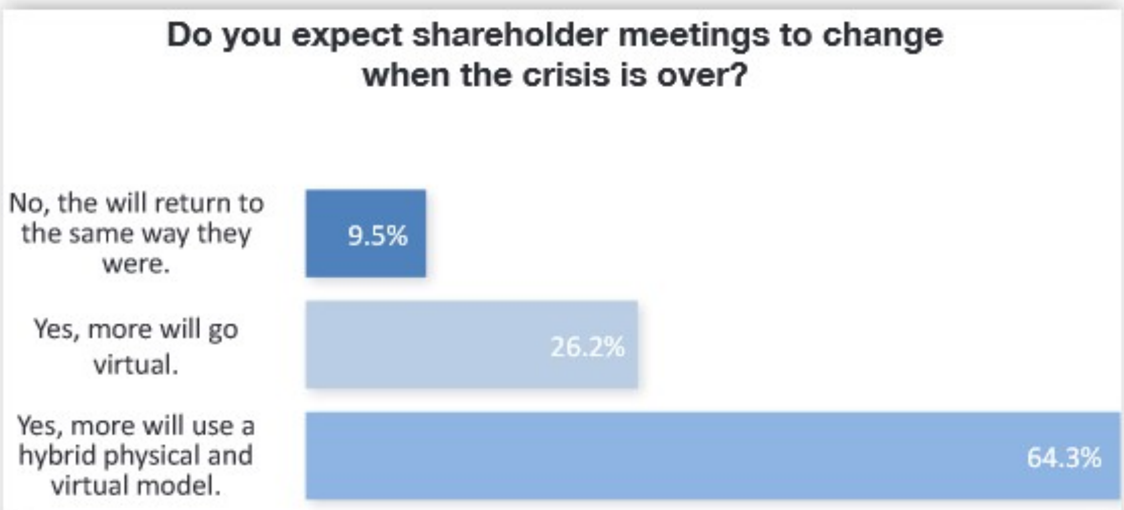
*"Making Corporate Purpose Tangible" available at https://higherlogicdownload.s3.amazonaws.com/GOVERNANCEPROFESSIONALS/a8892c7c-6297-4149-b9fc-378577d0b150/UploadedImages/2020_-_SquareWell_-_Corporate_Purpose_Survey__Photo___002_.pdf or SquareWell Partners: https://squarewell-partners.com/insights/

Investors Generally Pleased with Corporate Crisis Response

Proxy Insight's survey of 70 institutional investors and other stakeholders about companies' responsiveness to the crisis revealed* important indicators as respects perceptions of current performance and going forward expectations across a variety of trending topics including investor communications, crisis planning, capital management, and virtual shareholder meetings (VSM).

VSM takeaways include:

- As to VSMs generally, more than 82% of respondents affirmed their support for virtual meetings if certain standards are met to protect shareholder rights compared to just over 58% that affirmed their support of this format without the "shareholder rights" caveat. This compares to 81% who affirmed their support for hybrid meetings.
- Few respondents expect meetings to revert to pre-crisis mode, as shown here:



This implies that investors may have benefited from the greater access and participation opportunities associated with this year's VSMs in a way can't be matched with the in-person-only format subject to ensuring shareholder rights on par with an in-person meeting.

Also notable: Just ~8% reported dissatisfaction with companies' efforts to date to minimize disruption and just ~10% with companies' investor reporting. The majority of respondents expressed satisfaction on both fronts.

Respondents consisted of asset managers (58), asset owners (12), research/advocacy groups (7), law firms (6), government/regulator (1) and union group (1).

* "COVID-19: New Era for Corporate Governance" available at https://www.proxyinsight.com/wp-content/uploads/dlm_uploads/2020/06/Corporate-Governance-and-COVID-19.pdf

Investors Give Guidance to CEOs

FCLTGlobal / McKinsey's interviews with eight long-term investors elicited* sound advice for companies across multiple COVID-19 trending topics.

Key takeaways subject to any liquidity and going concern issues include:

- Prioritizing workforce health & safety
- Helping weaker customers and suppliers survive by retaining their business, if feasible
- Looking for and pursuing crisis-prompted opportunities (*e.g.*, M&A, new talent, less real estate)
- Reducing emphasis on dividends and stock repurchases
- Regular and transparent communications to investors about the impacts of the pandemic on the business and its prospects, whether and how it will recover

Importantly, all of the foregoing is couched in the context of each company's liquidity position, *i.e.*, investors don't expect companies with insufficient liquidity or going concern threats to take actions inconsistent with survival. However, if companies are experiencing liquidity issues, investors expect them to communicate frequently about their status and how these concerns are being managed or mitigated.

Investors represented Invesco, SSGA, Kindred Capital, Pzena Investment Management, Counterpoint Global, Autonomous Research US, Goldman Sachs, and MFS Investment Management.

* "Navigating COVID-19: Advice from long-term investors" available at https://www.fcltglobal.org/resource/covid-19-advice-investors/

COVID-19 Responsiveness: Investor Engagement

The Principles for Responsible Investment (PRI) published guidance* for investors on topics to address with their investee companies to gauge the quality of their responsiveness to the pandemic across the key themes of business continuity, employee health and well-being, and alignment with long-term value creation.

More specifically, the guidance consists of a series of questions for investors to ask across these categories and sub-topics:

Business continuity – for employers, suppliers and communities

- Operations
- Supply chain management and human rights
- Communication with stakeholders

Employee health and wellbeing – to ensure an engaged workforce

- Human capital management
- Safety and security of employees and customers

Alignment with long-term value creation

- Financial and strategic resiliency
- Financial alignment between the company and stakeholders
- A sustainable, net-zero economy

The guidance - which is intended to evolve based on investor feedback - was co-developed by the PRI, Business & Human Rights Resource Centre, CalSTRS, and APG and reflects contributions thus far from LGIM.

*"AGM Season 2020: Investor questions on COVID-19" available at https://www.unpri.org/covid-19-resources/agm-season-2020-investor-questions-on-covid-19/5828.article