Change Management

When Should Boards Consider Communicating Directly With Shareholders?

By Phyllis Deiso

"Engagement with shareholders should mean more than just mailing out the annual proxy statement and conducting the annual meeting. It should mean proactive outreach and clear, direct, and honest communications about how and why decisions are being made.…And the board of directors is—or ought to be—a central player in shareholder engagement." So declared Mary Jo White, then chair of the US Securities and Exchange Commission, at a Transatlantic Corporate Governance Dialogue event some years ago.

Increasingly since then, boards have provided more transparent written disclosures as to how and why decisions are made regarding, for example, compensation and the appointment of the company's auditor. Helpful, accurate information is deemed to inspire investor confidence. But how much of that information should come directly from the board? Should board members speak directly to investors on behalf of the company, at investor meetings, or not at all? Do the answers to these questions change when a significant corporate change or proxy battle is in the offing? At a minimum, are boards involved in managing or evaluating such communications?

Answers to these questions involve legal and practical issues. To be clear, there are some types of communication that are illegal. Providing material, nonpublic information to an individual can violate securities laws, specifically Regulation Fair Disclosure. The legal issues are best addressed by corporate counsel, but the practical issues should be discussed by the board so as to achieve consensus on the matter.

Of course, there are pros and cons to board members communicating directly with investors. The most likely benefits include diffusing potential controversy by providing accurate information to avoid any misunderstanding. There are specific contexts in which such engagement can be particularly helpful, such as when a go-private or merger transaction is proposed, when the CEO is leaving or under fire, when an activist investor is imposing pressure, during proxy season if compensation is an issue, or in the face of public regulatory investigations. In these situations, even if the board simply restates publicly disclosed information, direct communication could add credibility and alleviate shareholder concerns.

Some boards adopt the view of Greek philosopher Diogenes: "We have two ears and only one tongue so that we would listen more and speak less." Listening to shareholder concerns is an important part of effective engagement and can potentially reduce the likelihood of activism.

Cons of board members communicating directly with investors include the aforementioned legal concerns, the potential for saying something that is not aligned with management's views, disclosing sensitive or confidential information, and burdening already-busy directors.

After a fulsome dialogue in which the pros and cons are weighed, a board should develop a well-tailored set of best practices for situations where a director might be asked to speak on behalf of the company. Subject to company policies and legal advice, these practices can include the following:

- The company should think through what it is trying to accomplish by an important communication and have a plan to ensure the message is conveyed by the most appropriate spokesperson. This policy should include who approves the plan (e.g., investor relations, the CEO, or the board).
- Any communication should be agreed upon by the board and management in response to a specific situation or in keeping with company policy. There should be no rogue communications.
- The director deemed most suitable in a specific context should be designated to speak, and the company's investor relations officer should be present whenever a director issues a public communication.
- No material, nonpublic information should be conveyed.
- If there are legal concerns, the company's lawyers should be consulted.
- There should be formal, documented protocols regarding how a director should respond if approached by an individual investor, potentially referring all inquiries to investor relations.

The time to discuss director communications with investors is during a period of calm before a potential storm. This will allow the board to create a thoughtful communications plan that will optimize the benefits of shareholder engagement while minimizing the risks involved.

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