Shareholder Loyalty Is A 2-Way Street, Pension Funds Say

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Two large institutional investors on Wednesday urged independent board members across corporate America to reach out regularly to shareholders to head off problems before they erupt into ugly and expensive proxy fights.

Executives at Dutch pension fund manager PGGM Investments and Britain's RPMI Railpen Investments, which control about $200 billion in retirement investments, want to see more engagement from independent directors — those not holding executive positions at the companies they oversee — to “create a culture of no surprises.”

It's a tired tale this time of year: A company finds itself in a surprise proxy fight, courtesy of an uppity hedge fund. It runs to its trusted holders — institutional investors like PGGM and Railpen or money managers like Fidelity Investments — urging them to back management, promising better performance and seeking a firm showing of support.

Too little, too late, say these two shareholders, which hope to break the cycle.

“Understandably companies do not want to hear from shareholders only in times of distress,” said Deborah Gilshan, corporate governance counsel at Railpen, and Catherine Jackson, corporate governance adviser at PGGM. “However, equally, shareholders do not wish to be contacted by directors only when the company is in crisis and needs shareholder support.”

Writing in a blog post for Harvard Law School's corporate governance program, the executives said some boards do solicit input before proxy battles erupt, an “encouraging” sign. But that's not the norm, and the two pension funds said many boards scrape by with the bare minimum — federally required disclosure statements.

“We advocate for independent director meetings with shareholders to become a routine part of a board's approach to outreach with its shareholders, rather than only in exceptional circumstances or in times of crisis,” they said.

Proxy advisers and corporate communications experts regularly advise companies to mind the store and not take institutional support for granted. That's especially true in recent years, as the once-friendly mutual fund manager has become a less reliable ally.

T. Rowe Price Group Inc. and Southeastern Asset Management Inc. — neither of them hedge funds and neither known for rocking the boat — are leading the charge against the buyout of Dell Inc. BlackRock Inc. CEO Larry Fink recently sent a letter to 600 clients, reassuring them that the firm isn't in the pocket of company boards.

“Companies that don't have that ongoing interaction tend to be the ones that get caught off-

guard," said Brian Schaffer, who heads the M&A group at Prosek Partners, a New York communications firm. "You've got to be talking all the time to shareholders."

PGGM and Railpen have placed much of the responsibility at the feet of the board members without a C-suite office. Independent directors have a special duty to look out for shareholders, especially in companies where management has a big stake or where the CEO and chairman roles are combined, they said.

On executive compensation, strategy, risk management and succession planning, independent directors should be shareholders' primary contact, the pension funds said. For issues on operations and growth strategy, management is a better fit — a sentiment Schaffer echoed.

"If I am an investor, I want to talk to the people responsible for running the company day-in and day-out and who have a firm handle on a company's operations and financial positioning, not a board member, who by design, is removed from that role," he said.

The comments come as proxy season moves into full swing. More than 250 companies will hold annual meetings over the next three weeks, and many of them — Gleacher & Co., Tessera Technologies Inc., Stillwater Mining Co., Transocean Ltd. and Compuware Corp., among others — are facing board nomination fights from activist investors.

A lucky few, most notably Agrium Corp., have survived such challenges in recent weeks, while others, like Hess Corp., have made swift changes to their business plans to avoid them.

While not commenting on any active battles, PGGM and Railpen noted that good communication with institutional investors could go a long way toward stacking a company's corner with allies if and when such a challenge emerges.

"It is no longer acceptable for board directors … to be perceived as hiding behind policies of delegation, while expecting to be re-elected year after year.," they said. "Engagement is a two-way process."