Compensation

2011 Proxy Season Lessons Learned

By Nora McCord

The recent proxy season, the first with universal say-on-pay, was a non-event for many companies. Although a number of companies were forced to make hasty, last-minute modifications to pay programs to secure favorable say-on-pay votes (despite "no" recommendations by ISS for about 13 percent of companies), only about 1.5 percent failed say-on-pay votes.

However, the cost of losing a say-on-pay vote is high. In addition to the obvious reputational damage, recent court decisions have indicated that these companies face a very real threat of lawsuits, as well as the potential for future "withhold" vote campaigns against directors.

There are also indications that the upcoming proxy season may not be as straightforward as the last. Recent economic volatility may negatively affect corporate performance, rhetoric against excessive executive compensation is on the rise, and voting methodologies for proxy voting advisory firms and others are expected to change but are currently unknown. For all of these reasons, the cost of "getting it wrong" has never been higher.

The good news is that we now know a great deal more about how to design an effective shareholder outreach program. Below are five recommendations for companies developing shareholder outreach programs to secure favorable say-on-pay votes.

1. Prioritize outreach efforts. When communicating with shareholders, companies should prioritize those who voted against say on pay. Additionally, understand the impact proxy voting advisory firms may have on the vote, and be sure to include them in outreach efforts if they influence a meaningful percentage of the vote.

2. Time conversations well. While many shareholders are open to greater dialogue with portfolio companies, the timing of these conversations matters. Everyone is busy during proxy season. Shareholders appreciate off-season meetings, which permit more thoughtful discussions. To avoid shareholder fatigue, if possible, schedule meetings in the early to mid-summer, rather than late fall. That said, addressing compensation in discussions with shareholders throughout the year is probably the best approach.

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3. Don't assume shareholders have read your entire CD&A. CD&As are longer than ever before, and many companies appear to have focused on providing more information rather than ensuring the right information is presented in the most compelling format. In our experience this is a critical distinction. In follow-up meetings this summer, the number of shareholders reporting that they have not read the entire proxy is surprising, even in preparation for an off-season meeting.

4. Draft a strong executive summary for your CD&A. The executive summary should convey the entire pay-for-performance story and include everything necessary to ensure a positive say-on-pay vote. It should cover the basic aspects of the program, the rationale for any elements that might be viewed negatively by shareholders, an overview of company accomplishments and related pay decisions, and a summary of pay and governance best practices in place at the company.

The executive summary should function as a stand-alone document that can be used in face-to-face meetings with shareholders and posted in the investor relations section of the company's website. Conversations with some major shareholders suggest that they will look for and rely upon this material if it is available.

5. Listen to your shareholders. Listening to shareholders is just as important as educating them. In our experience, the say-on-pay vote is a relatively blunt instrument. Face-to-face dialogue with shareholders often provides valuable insight into what really matters to them. For example, some shareholders vote against companies simply because they grant options or provide gross-ups, regardless of the rationale, while many shareholders vote automatically inline with the recommendation of their proxy voting advisory firm. Often, knowing exactly what drives votes, and how strongly held the views are, can only be garnered through in-person conversations.

To be effective, shareholder engagement must become a year-round endeavor. Once an anomaly, regular and candid engagement with shareholders is rapidly becoming the norm. With proper planning, say-on-pay votes will never be a surprise.

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