ISSUES FOR COMPANIES: 2020

As the 2020 annual meeting season approaches, companies and investors alike are facing a new environment and new challenges that will substantially alter traditional shareholder relations practices.

In this year's client memo, **A Common-Sense Approach to Corporate Purpose, ESG and Sustainability**, we describe this changing environment and the difficult questions it raises for both companies and institutional investors.

The purpose of this year's **Issues for Companies** is to help guide our clients through this period of intense change and provide advice that will facilitate and strengthen their relations with shareholders and stakeholders for the long term.

1. **ESG Integration**

   Environmental and social issues have joined corporate governance as key risks and opportunities for companies. Academic studies confirm ESG's impact on corporate financial performance. The challenge for companies is to explain how their ESG policies and practices are central to their risk management, value creation, business strategy and long-term performance goals. The parallel challenge for investors is to integrate ESG and intangibles into their investment models as well as their stewardship policies and their oversight of portfolio companies.

2. **Corporate Purpose and Culture**

   In August 2019 the U.S. Business Roundtable joined BlackRock and other large institutional investors in redefining corporate purpose to include responsibility for stakeholders as well as shareholders.

This shift away from shareholder primacy recognizes that the board of directors must represent a broader set of constituents affected by the company's business. Internally, expanded corporate purpose focuses a spotlight on corporate culture, human capital management, tone at the top and reputation risk in addition to shareholder return.

3. Sustainability

In another major shift of focus, "sustainability" has subsumed the long-standing issue of short-term versus long-term business practices. Sustainability embraces a broad set of topics that includes climate change, environmental practices, social policies and the interests of stakeholders, employees, customers and even the communities and economies affected by corporate activities. The proliferation of competing definitions, standards and metrics relating to sustainability complicate companies' disclosure practices and their efforts to maintain comparability in the marketplace.

4. Corporate Reporting and Shareholder Communication

ESG, corporate purpose and sustainability test the limits of traditional disclosure rules that govern corporate reporting. At the same time, these issues create an opportunity for companies to "tell their story" in their own voice. To do so companies can make more effective use of comply-or-explain reporting, develop new approaches to traditional disclosure, or introduce integrated reporting techniques. Pressure for customized narratives on endogenous sustainability issues is likely to encounter legal concerns, require greater collaboration among traditional corporate roles and reduce reliance on compliance with external standards.

5. Board Accountability

The buck stops with the board of directors on matters of ESG, corporate purpose and sustainability. Trust in the board's ability to oversee the corporation requires greater transparency about board composition, diversity and skills. Investors want more detailed information on a growing list of board responsibilities, including compensation, technology, cyber security, ethics, conflicts of interest, responsiveness to stakeholder interests, willingness to engage and the effectiveness of the board's self-evaluation process.

6. ## Engagement

Companies' willingness to have their directors and senior executives engage in direct meetings with investors is now firmly established. Questions remain as to how the practice should be conducted. Should there be separate governance/ESG road shows, or should ESG topics be combined with IR and financial communications? Which directors should be involved and under what circumstances? Which shareholders should be targeted? Answers to these questions require careful analysis of the ownership profile as well as the company's competitive issues, strategic goals and vulnerability to activism.

7. ## Compensation

Compensation will maintain its position as the critical issue for companies, investors and proxy advisory firms in 2020. Investor demand for specifics on how companies are integrating sustainability performance metrics into their compensation programs will create pressure for companies that do not formulaically include measurable environmental and/or social metrics into their incentive programs; for those companies that already include non-financial metrics in their assessment of executive performance, whether they are quantifiably measured or merely qualitatively in a discretionary manner that does not include specific targets, may be scrutinized. Additionally, updates to ISS and Glass Lewis methodologies for evaluating Say on Pay in 2020 create additional uncertainty with respect to each firm's Say on Pay recommendation.

8. ## M&A and Activism

Will there be more activism in 2020 because ESG expands the issues that activists can exploit? Or will there be less activism because ESG requires companies to increase their communication and engagement, thereby strengthening their relationship with investors and reducing their vulnerability to activism? The 2020 annual meeting season will begin to answer this question. In any case, there will continue to be activism focused on underperformance and strategic differences, particularly on M & A transactions ("spoilers" seeking "bumpitrage"). If past trends continue, there will be more behind-the-scenes activism and more settlements; "active ownership" by "passive" institutional investors will increase; strategic activists will maintain their role as a legitimized market force.

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