Insights
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The Role of Long-Term Shareholder Voice: Bridging the Time-horizon Gap to Create Long-term Value

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Key Takeaways

1 As a long-term investor, representing quasi-permanent capital for companies held in our clients' index portfolios, we are uniquely positioned and incentivized to encourage portfolio companies to consider long-term risks and opportunities in order to maximize long-term value for our clients.

2 With many portfolio companies improving their shareholder engagement practices and approach to long-term financially material issues, our support for incumbent directors in contested elections has steadily increased over the last five years, reaching a new high in 2022.

3 Some activist shareholders, companies, and policymakers are engaging in and/or proposing activities that can circumvent shareholder voice; such measures could result in capital markets characterized by a focus on short-termism, amplifying the influence of certain investors and stakeholders, often with limited investment time horizons.

4 Boards and management teams that focus on managing material risks and emerging opportunities can maximize value for both companies and their diverse shareholder bases, hereby bridging the gap between short and long-term interests.

Introduction: A Critical Juncture for Shareholders

Faced with inflationary pressures, geopolitical uncertainty, and market volatility, companies' commitment to an elevated culture of shareholder engagement has never been more critical. Coupled with these headwinds are the introduction of a universal proxy card and a shifting legislative environment. These developments have the potential to significantly alter the landscape of shareholder activism.

The universal proxy card (see page 4) presents a meaningful shift in how investors participate in shareholder democracy, as well as how companies and activist shareholders approach contested elections. In parallel with this development, new measures are currently being considered by policymakers, which intend to further empower individual investors. While we are supportive of the spirit and intent of these proposals to democratize the voice of shareholders, without thoughtful implementation these measures may result in unintended consequences for investors and companies alike.

At the same time, a short-term focus is being demonstrated by company actions, activist shareholder settlements, and legislative proposals, each of which has the potential to silence the long-term shareholder voice. Against this backdrop, the importance of considering long-term perspectives in these discussions has never been more important.

Our Role as a Long-term Investor amidst Diverse Shareholder Views

We appreciate that different investors have a broad spectrum of investment philosophes, risk appetites, and time horizons. We respect this diversity and value building relationships with our portfolio companies given our mutual objective of achieving long-term, risk-adjusted returns for our clients, who are the underlying shareholders in these companies. As a long-term investor, particularly in our index portfolios where we own a company for the duration of its inclusion in the index, we are a stabilizing force for our portfolio companies. We are uniquely positioned and incentivized to use our stewardship tools to encourage portfolio companies to consider long-term risks and opportunities, in an effort to create long-term value for our clients.[1]

By providing cost-effective and efficient vehicles to achieve diversification, our index products have increased access to financial markets for all investors — from individual workers saving for retirement to the world's most sophisticated institutional investors.

State Street Global Advisors' Asset Stewardship team aims to address all financially material issues — including environmental, social, and governance ("ESG") issues — through our proxy voting and company engagement, thereby promoting the reduction of risk in our clients' investments. In pursuing this mission, we have long recognized that activist shareholders can bring positive change to underperforming companies,[2] particularly when boards or management do not respond to investor concerns. However, we are wary of activist shareholder models of engagement that favor short-term gains at the expense of long-term investor interests.

Our Approach to Engaging with Activist Shareholders and Nominee Candidates

We have a broad history of constructive engagement with management and boards of our portfolio companies, as well as with the activist shareholders who challenge them. This has occurred through dialogue and/or proxy contests. In recent years, we have increasingly witnessed activist shareholders dive deeper into emerging areas of company performance and board oversight, including financially material ESG issues.[3] As a result, board candidates increasingly offer multidisciplinary expertise in addition to direct industry experience.[4]

Activist shareholders, often with short-term time horizons, would be well served to focus on bridging the gap between short and long-term interests. By demonstrating a compelling case for how their proposed strategy and director nominees are superior to the incumbent's approach to value creation, activist shareholders could increase their base of support among voting shareholders. A focus on this approach is particularly relevant in today's market environment marked by volatility and uncertainty, in which activist shareholders may be incentivized to drive their agendas and advocate for change.[5]

Despite a renewed focus on director quality by activist shareholders, our support for incumbent directors in proxy contests has increased year-over-year since 2017, reaching a new high in 2022 as seen in Figure 1.[6]

This increase in support can be attributed to:

- A lack of focus and substance on long-term strategy in dissidents' rationale, coupled with engagement models that over-emphasize short-term performance periods, which come at the expense of long-term investor interests and could result in the "greenwashing" of ESG issues[7]

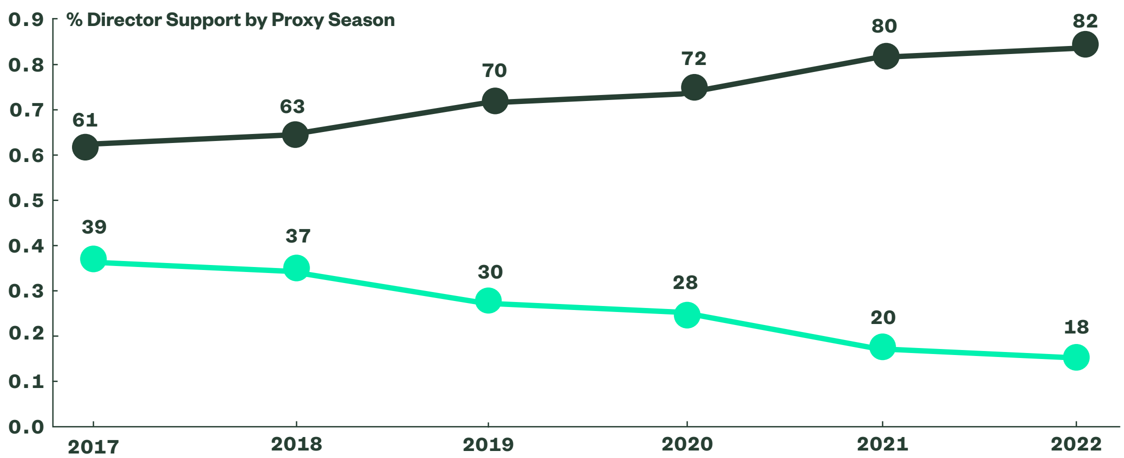
- The greater responsiveness of incumbent management and boards of target companies, as well as improved board independence, enhanced focus on ongoing board refreshment, and elevated quality and experience of incumbent directors

- Our commitment to standing behind portfolio companies during the global pandemic, while they focused on financial resiliency and navigated immediate challenges, including employee health, customer protection, and supply chain safety

Figure 1
Our Support in Global Proxy Contests, 2017–2022

% Support by Proxy Season

Management
Dissident



Source: State Street Global Advisors, September 2022.

Our approach to nominee selection reflects our belief that strong, independent, and effective boards underpin value creation at companies in which we invest. On behalf of the company's shareholders, Boards: 1) oversee management; 2) provide guidance on strategic matters; 3) select the CEO and other senior executives; 4) create a succession plan for the board and management; 5) provide risk oversight; and, 6) assess the performance of the management team.[8]

As previously emphasized, nominating committees that comprise independent directors are best placed to assess which individuals can properly fulfill these duties, and act as effective fiduciaries. As long-term shareholders, we vote for members of the board, including nominating committee members, who play a critical role in determining board composition. While our default position is to support the committees' judgement, we consider the following factors when evaluating dissident nominees:

- Strategy presented by dissident nominees versus that of current management, as overseen by the incumbent board
- Effectiveness, quality, and experience of the management slate
- Material governance failures and the level of responsiveness to shareholder concerns and market signals by the incumbent board
- Sustained company underperformance and lack of a compelling recovery plan
- History of both company and activist shareholder engagement cultures

Universal Proxy

Starting August 31, 2022, the use of universal proxy cards is now required in all non-exempt director election contests at publicly-traded companies in the US.[9] The changes are as follows:

- Shareholders voting by proxy in contested elections have the same flexibility in voting for directors as shareholders who physically attend and vote at the shareholder meeting
- All shareholders have the ability to vote for a combination of director nominees from competing slates, gaining the ability to "mix and match" for the first time
- The minimum share ownership required for shareholders to nominate a director to the board has been significantly lowered, decreasing associated costs and barriers to entry

Academic evidence has indicated this change will not systemically favor either activist shareholders or incumbent boards.[10] As such, we welcome this development, since it has the potential to strengthen shareholder voice and may lead to more balanced vote outcomes.[11]

Nonetheless, we will carefully monitor evidence of an increase in the following possible outcomes, as well as their potential unintended consequences:

- Settlements between activist shareholders and companies, with board seats used as bargaining chips[12]
- Proxy campaigns used in place of shareholder proposals to further a broader set of topics of interest to shareholders
- Contested elections due to decreased cost and lower barriers to entry[13]

As long-term investors in portfolio companies on behalf of our clients, we will remain invested well after dissident directors leave the board and short-term investors exit the stock. We believe that leveraging board seats as bargaining chips diminishes shareholder democracy. This also mutes our opportunity to advocate for a company's long-term performance that aligns with our clients' interests.

Upholding Shareholder Democracy

Despite improvement in shareholder engagement, companies are increasingly engaging in entrenchment tactics that circumvent shareholder voice and the democratic process. These developments come against the backdrop of recent market volatility, the global pandemic, and inflationary concerns. Such practices include, but are not limited to:

- Entering into preferred financing agreements that require investors to vote their shares in line with all management proposals
- Establishing new special voting class shares (e.g., "Founder's shares") well after the company has gone public
- Failing to provide sufficient disclosure that explains compelling rationale behind changes to shareholder rights, capital allocation, and/or governance structure
- Refusing to engage constructively with shareholders regarding board composition, shareholder rights, or competitive offers to buy the company and/or its assets
- Adopting shareholder rights plans ("poison pills") with no time-bound limits and/or compelling rationale

Unsurprisingly, these company actions are often cited by activist shareholders in their argument for board refreshment.[14] Through our engagement with portfolio companies and activist shareholders, we will continue to apply close scrutiny to the practices above.

Supporting Investor Choice on Proxy Voting

We are supportive of giving our clients greater choice around how their shares are voted. Today, clients invested through our separately managed account structures have the option to retain proxy voting authority over the securities held in their accounts that we manage for them. We are continuing to explore the possibility of providing investor choice to more products and client types.

In parallel with this client offering, some policymakers have proposed new measures that intend to further empower individual investors. While we are supportive of the spirit of these legislative proposals, we are concerned by possible unintended consequences, including:

- Amplifying the voting influence of select shareholders, such as activists with short-term interests, those outsourcing responsibility to proxy research advisors, and company insiders
- Creating challenges for companies to reach a voting quorum
- Diminishing the opportunity for clients to benefit from the experience of institutional investors in exercising a long-term perspective in voting decisions

The Long-Term Shareholder Provides a Stabilizing Voice

In an environment increasingly defined by market volatility and the outsized influence of a few short-term oriented actors, long-term shareholders play a unique and important role. Shareholders focused on maximizing long-term value creation and sound corporate governance practices — a precondition for long-term performance — are more important than ever. Indeed, when making any significant decisions relating to capital allocation and long-term strategy, particularly those with voting implications, companies can benefit from soliciting and considering the long-term shareholder voice in this process.

Investors with long-term horizons, sufficient resources, and productive relationships with their portfolio companies are ideally positioned to deliver value for their clients. These stewards of capital can advocate for enhanced governance practices and risk mitigation of financially material issues, and keep companies focused on long-term strategy.

For these reasons, defensive company entrenchment tactics, last-minute settlements with activist shareholders, and evolving legislative environments all have the potential to cause adverse effects on constructive engagement — silencing the voice of long-term shareholders and potentially upending shareholder democracy. This outcome would be detrimental to the critical role that effective boards — who are elected by shareholders to represent their interests — play in keeping management focused on the long-term goals of their companies.

Conclusion: Bridging the Time-Horizon Gap

The diverse investment philosophies among capital markets participants represent an inherent mismatch between investors with short and long-term time horizons. As a long-term investor, and stabilizing presence for our portfolio companies, we provide a consistent and constructive voice to portfolio companies through our voting and engagement activities.

While our quasi-permanent holding period may differ from that of activist shareholders, enhancing long-term value creation at companies that we both own is a mutually beneficial goal. Boards and management teams can bridge the gap between short and long-term interests by remaining focused on managing material risks and emerging opportunities.

Activist shareholders can better build consensus among voting shareholders by nominating dissident directors focused on long-term strategy and value creation. Generally, director nominees who serve as responsible stewards by fulfilling their fiduciary duty will more likely have the support of long-term shareholders.

At State Street Global Advisors, we will continue to serve as a constructive partner to our portfolio companies and a consistent voice to their boards and management teams. In contested elections, we will continue to engage with both companies and activist shareholders, giving stronger consideration to approaches that bridge short and long-term interests. This will effectively improve long-term, risk-adjusted returns, well after activist shareholders exit an investment.

While there may always be an inherent divergence between investors with short and long-term objectives, we believe that healthy competition, constructive dialogue, and transparent debate fuel shareholder democracy. As such, resisting any efforts to disenfranchise the voice of long-term shareholders will benefit the average investor, who has benefited greatly from the development of strong and efficient capital markets.

Endnotes

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About State Street Global Advisors

Our clients are the world's governments, institutions and financial advisors. To help them achieve their financial goals we live our guiding principles each and every day:

- Start with rigor
- Build from breadth
- Invest as stewards
- Invent the future

For four decades, these principles have helped us be the quiet power in a tumultuous investing world. Helping millions of people secure their financial futures. This takes each of our employees in 29 offices around the world, and a firm-wide conviction that we can always do it better. As a result, we are the world's fourth-largest asset manager* with US $3.26 trillion† under our care.

* Pensions & Investments Research Center, as of December 31, 2021.
† This figure is presented as of September 30, 2022 and includes approximately $55.12 billion USD of assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated. Please note all AUM is unaudited.