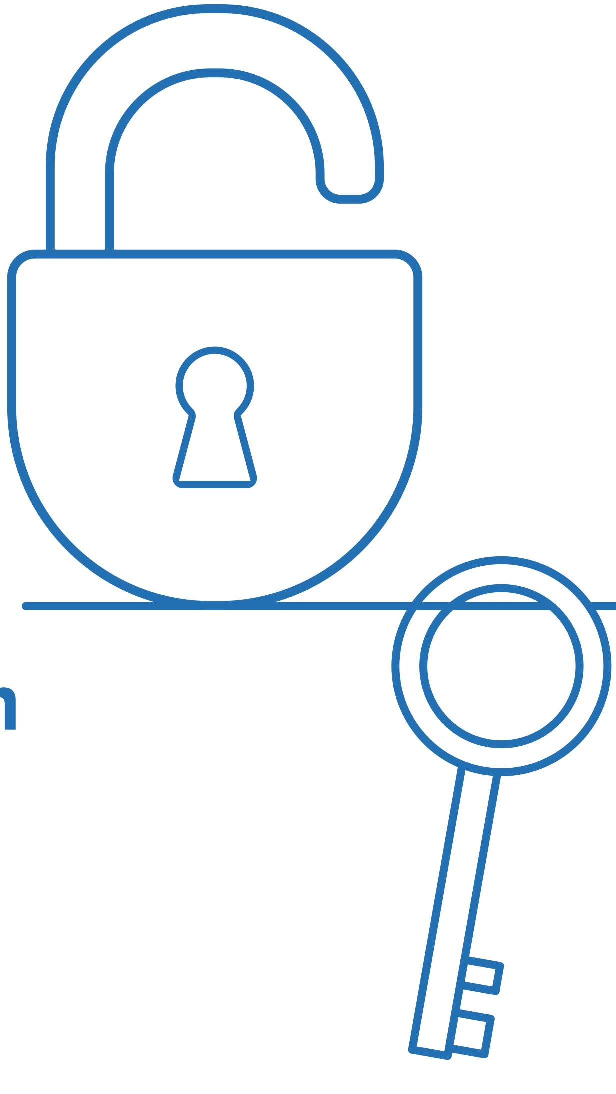
FCLTGLOBAL
FOCUSING CAPITAL ON THE LONG TERM

REPORT

Unlocking Value by Targeting Long-term Shareholders



FCLTGLOBAL

MARCH 2023

Focusing capital on the long term to support a sustainable and prosperous economy.

Millions of people around the world are saving money to meet personal goals—funding a comfortable retirement, saving for someone's education, or buying a home, to name a few.

The funds to support these goals are safeguarded by institutional investors—pension funds, sovereign wealth funds, insurers, and asset managers—who invest in companies for the prospect of growth and security. These savers, their communities, and the institutions that support them make up the global investment value chain, and each benefit from long-term decisions in different ways.

Data shows that long-term-oriented investors deliver superior performance, and long-term-oriented companies outperform in terms of revenue, earnings, and job creation. But despite overwhelming evidence of the superiority of long-term investments, short-term pressures are hard to avoid. A majority of corporate executives agree that longer time horizons for business decisions would improve performance, and yet half say they would delay value-creating projects if it would mean missing quarterly earnings targets.

Today, the balance remains skewed toward short-term financial targets at the expense of long-term value creation.

FCLTGlobal's mission is to focus capital on the long term to support a sustainable and prosperous economy. We are a non-profit organization whose members are leading companies and investors worldwide that develops actionable research and tools to drive longterm value creation for savers and communities.

MEMBERS

AIA, AIMCo, AON, apg, Baillie Gifford, BainCapital, Bank of America, Barclays, BlackRock, Blackstone,
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EXECUTIVE SUMMARY

Attracting the right shareholders can make or break a long-term corporate strategy. But many companies struggle with how to engage shareholders to support their long-term strategy and instead focus on the broader "investment community." Creating a targeted shareholder strategy can unlock significant long-term value.

Research of 250 of the largest companies across the U.S., Canada, and Europe revealed that the presence of a notable long-term shareholder base is associated with positive corporate results.[1] All else equal, a 10% increase in the proportion of long-term shareholders is associated with: [2]

- 8% higher long-term ROIC over a cumulative 5-year period,
- 3% and 4% higher allocation towards Research and Development (R&D) and Capital Expenditure projects respectively,
- 5% lower propensity to issue quarterly guidance.

However, there are serious disconnects between investors and companies in the engagement process. Our findings reveal that:

- Over 60% of companies surveyed faced hurdles in accessing long-term oriented investors.
- 85% of investors surveyed aim to talk to either senior management or the board of directors when engaging with their portfolio companies, but only 40% actually do.
- 50% of companies surveyed aim to talk to portfolio managers when engaging with their shareholder representatives, but only 28% of them actually do.
- Only 50% of the companies proactively tailored their investors communications by investor type, even though 90% of investors consider who else holds the stock.

To increase shareholder commitment to long-term strategies, companies can leverage shareholder base characteristics to engage with the right people. Specifically, companies can:

- Target long-term shareholders strategically, rather than the whole "investment community"
- Engage deeply with their large, long-term shareholders
- Reward investor relations professionals for increasing the proportion of long-term shareholders in their company

Having a long-term shareholder base that understands the corporate strategy and engages with deep, strategic dialogue can unlock durable value.

4 MYTHS ABOUT CORPORATE SHAREHOLDER BASES

1. Shareholder bases look the same all around the world (Page 8)
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3. Shareholders ask key questions during earnings calls (Page 9)
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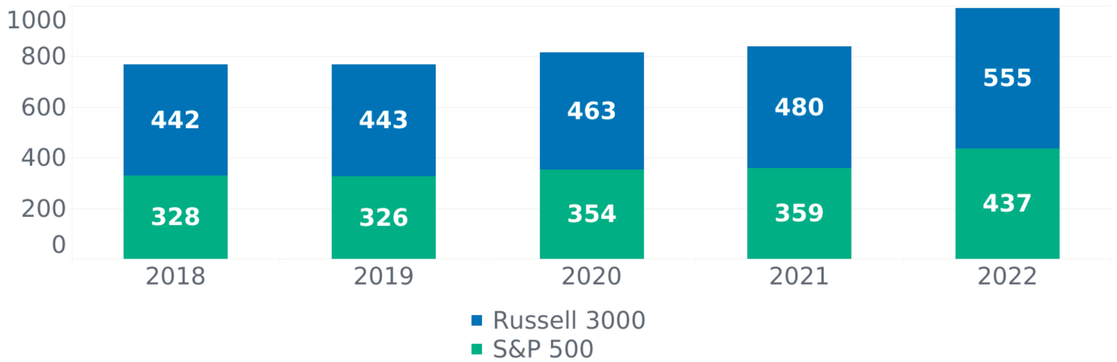
UNLOCKING VALUE BY TARGETING LONG-TERM SHAREHOLDERS

The investor-corporate dialogue remains one of the most important avenues for unlocking the value of a long-term corporate strategy, but both active owners and activists can also derail the execution of that long-term strategy.

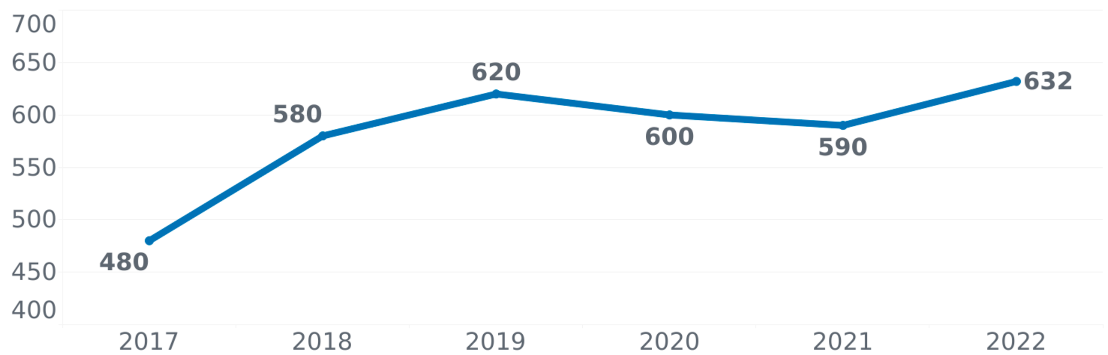
Shareholders filed a record number of proposals in 2022. In the United States, combined proposals at S&P 500 and Russell 3000 companies totaled nearly 1,000, an 18% increase over the previous year (Exhibit 1). In Japan, there was an 80% increase in the total number of shareholder proposals year-over-year, and a 60% increase in the number of companies subject to shareholder proposals.[3]

Exhibit 1: Total Shareholder Proposals 2018-2022: S&P 500 and Russell 3000[4]



Concurrent with the increase in shareholder proposals, activists are also making a comeback. Bloomberg shows that the level of activist campaigns in 2022 rebounded to pre-pandemic levels, reaching a five-year high (Exhibit 2).

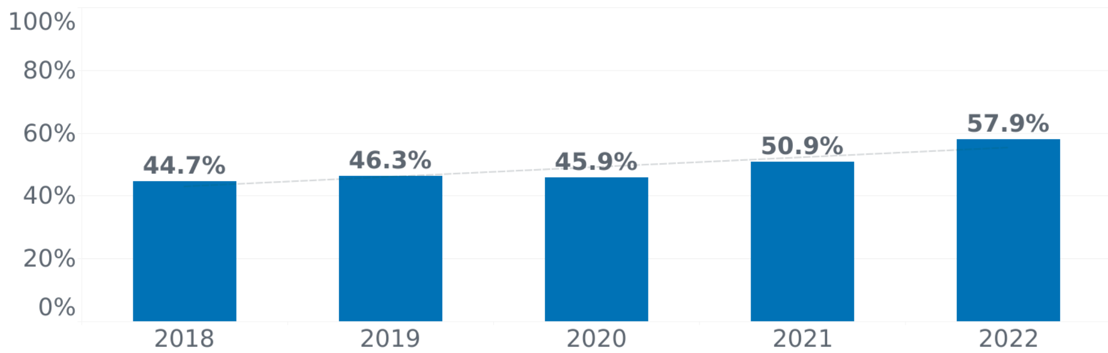
Exhibit 2: Total investor activism campaigns launched against all sectors, 2017-2022[5]



Short-term activists are often focused on maximizing margins and returns in the near term. Companies, then, can be pressured to roll back activities that are not beneficial to short-term financial performance, such as investing in longer-term R&D projects or increased wages and additional employee benefits, even though research shows that such activities lead to greater long-term success.[6]

In addition, companies face a new wave of active owners eager to engage on a broader suite of topics – environmental and social issues now dominate engagement conversations, shareholder resolutions, and proxy battles. The number of shareholder proposals related to these issues has steadily increased over the years, reaching a high of 58% at Russell 3000 companies in 2022 (Exhibit 3). Compared to 2018, companies face greater pressure than ever to deliver on their climate commitments and meet responsibilities to a larger group of stakeholders.[7]

Exhibit 3: Percent of Shareholder Proposals on Environmental and Social Issues, Russell 3000[8]



Disconnects between investors and the company on strategy threaten long-term performance

Companies often struggle to meet the multitude of (sometimes conflicting) demands from their different investors. FCLTGlobal's members have lamented:

...for us, it's very much about messaging to investors in our investor/corporate dialogue, finding the right way to align and communicate our long-term strategy with our shareholders. However, we cannot control who owns our company and we're oftentimes under pressure from multiple parties...

FCLTGlobal Corporate Member

Furthermore, investors expect and appreciate a clear, targeted engagement strategy, rather than engaging in one moment and disregarding their input the next.

...the pain point for us has been varying levels of consistency and success in our engagement. The same 1-2% ownership stake in a company will get us many productive conversations with some companies, but for others they wouldn't even take our calls...

FCLTGlobal Investor Member

The resulting disconnect leaves both companies and investors unhappy: companies blame investors for short-term pressures that distract from long-term strategy, and investors blame companies for a lack of organized engagement around that strategy. As a result, many companies act in sub-optimal, short-term ways to satisfy their misperception of what their shareholders want (e.g. cutting R&D expense to meet EPS targets, or overdistribution of capital by way of dividends and buybacks), ultimately reducing their firm's long-term value.[9]

How do companies and investors stop the finger-pointing and deliver more productive conversations? Companies that understand their shareholder base and targeting their investor communications strategy towards long-term shareholders can unlock significant value.

Long-term shareholder bases support corporate focus

Long-term shareholders can act as an important partner to companies who want to stay focused on building their long-term vision.

For companies, support from these investors can provide a much-needed buffer in a close proxy fight or against an activist agenda that may undermine a company's long-term strategy.

To this point, academic evidence shows that long-term shareholder bases positively affect share price and engagement experiences. Specifically, Bushee (1998) found that firms with a larger proportion of short-term (transient) owners are more likely to cut R&D investments to reverse an earnings decline and experience greater increases to stock return volatility. [10, 11]

And while some companies resign themselves to the assumption that they cannot control who owns their shares, Serafeim and Knauer (2015) assert that companies that have implemented a robust strategy to integrate and report sustainability efforts attract longer-term investors, with the signal being stronger for non-family-controlled firms (Seraphim 2015).[12, 13] IIn addition, FCLTGlobal's previous research shows that there are indeed ways for companies to attract committed long-term investors.[14]

Having a strong long-term shareholder base is beneficial for the other holders of that company as well. For example, Bauer et. al (2022) discovered that shareholder engagement on financially material matters is significantly linked to improvement in profitability, sales, and cost ratios.[15] Furthermore, Edmans and Holderness (2017) discovered that blockholders (large shareholders with more than 5% ownership of a company) play a crucial role in corporate governance: through both "voice" (engagement with companies), and the threat of "exit" (selling shares and directly affecting firm value).[16]

Our findings show the major gaps between companies and investors

Our analysis finds that major gaps exist in current engagement experiences between companies and investors, even though both would benefit from better engagement. Using the methodology listed below, we found that:

- Scattershot investor engagement strategies often fail to meet the range of different shareholder objectives.
- Having a long-term shareholder base can unlock value in the form of higher long-term ROIC, and higher CapEx, and R&D allocations.

Methodology and data construction

To build on previous academic studies, we collected our own datasets and conducted original research on this topic. Bushee's work is only applicable to US companies and does not consider the influence of insider and government ownership. In addition, many studies are well over a decade old, before many of the sustainability issues were prevalent.

- For share price:
  - We collected an original dataset consisting of the largest companies of the MSCI ACWI by 2021 market cap (100 US, 100 European, 50 Canadian)[17]
  - Coverage of shareholder base compositions was taken for the years 2010-2021
  - Additional financial and ESG data were taken from Refinitiv Eikon, and FactSet
- For engagement experiences:
  - We conducted a survey with similar questions posed to both companies and investors to identify pain points, inconsistencies, and gaps in the corporate versus investor experience.

For additional details on our research approach, including limitations and areas for further research, please refer to the Appendix.

Corporate Analysis

From our analysis, we find that a long-term shareholder base is associated with long-term value. These results vary slightly from region to region.

In the U.S.:

- A 10% increase in the proportion of long-term shareholders is associated with an 8% increase in return on invested capital (ROIC) over a period of 5 years.
- This same 10% increase is also associated with significantly higher allocation to CapEx (4%) and R&D (3%), and lower prevalence of providing quarterly guidance (5%).
- Conversely, firms with the highest proportion of short-term shareholders had less diverse boards and significantly lower ESG controversy scores.

In Canada:

- A 10% increase in insider ownership was associated with a 5% increase in ROIC over 5 years, but also a 2% increase in volatility in ROIC.
- This same increase in insider ownership was also linked to significantly higher, but more dispersed, ESG scores at the extremes.

In Europe:

- A 10% increase in long-term shareholder base was associated with a 4% increase in ROIC over 5 years.
- Additionally, a 10% increase in short-term shareholder base was associated with lower ESG scores, less diverse boards, and higher leverage.
- Companies with the highest proportion of government and insider ownership had higher, but more volatile, sales growth and ESG controversy scores.[18]

Myth 1: Shareholder bases look the same all around the world

Fact: The shareholder bases of Canadian and European companies vastly differ from their US and UK counterparts

More on Geographic Differences

Two characteristics are common among European (and to a lesser extent, Canadian) companies vs. US and UK companies.

1. Many companies are heavily insider-owned (family direct or via trust/foundation)
2. Many companies have a decent amount of employee-ownership

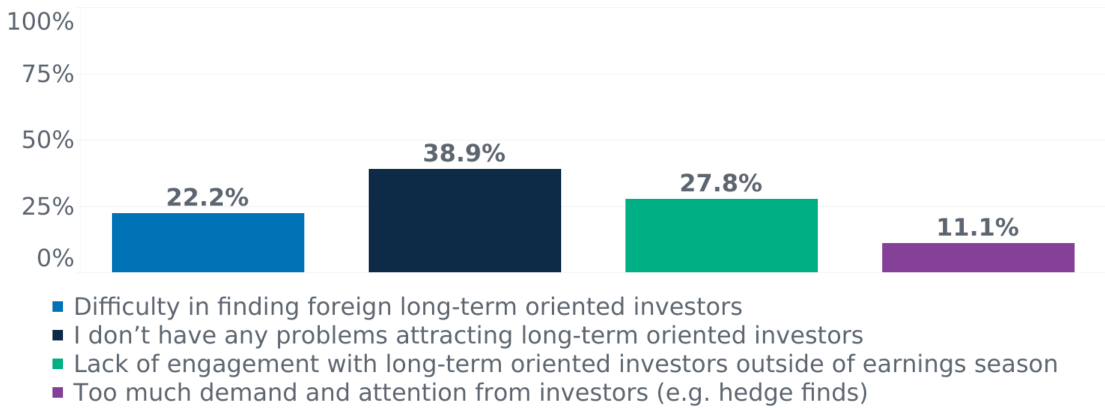
As such, compared to large, predominantly institutionally-owned U.S. or U.K. firms, the ability for institutional investors to influence Canadian or European firms (many of which are family-owned) through proxy voting and shareholder proposals is more limited.

Survey Reponses

Responses to our survey show that major gaps exist in current engagement experiences between companies and investors:

1. **Over 60% of corporations surveyed face hurdles in attracting long-term oriented investors**

What has been the biggest hurdle to attracting long-term-oriented investors?



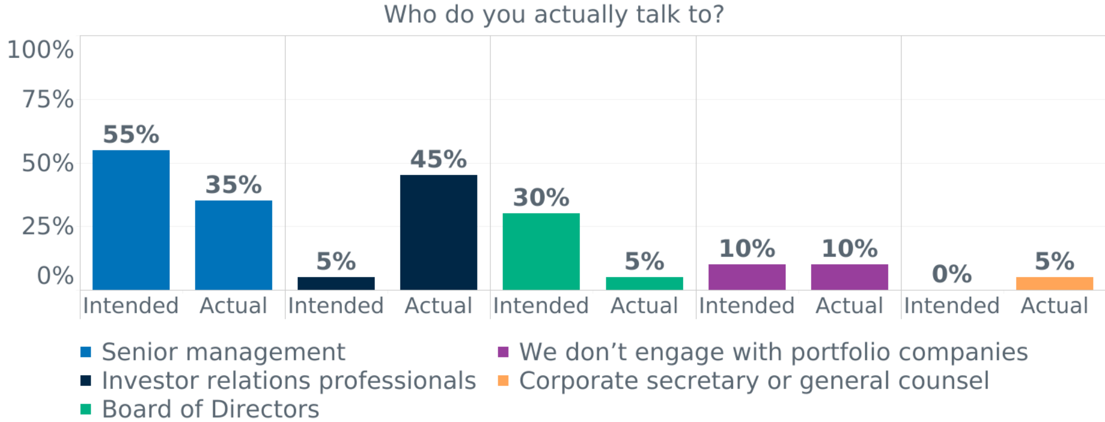
Companies spend too much time with short-term investors and the sell-side, relative to long-term oriented investors.

Myth 2: It is important to engage with the sell-side to attract long-term shareholders

Fact: Some sell-side analysts actively sell "corporate access" to shorter-term shareholders like hedge funds and activists

2. **85% of investors survey aim to talk to either senior management or the board of directors when engaging with their portfolio companies, but only 40% actually do**

Who do you intend to talk to when engaging with portfolio companies?
Who do you actually talk to?

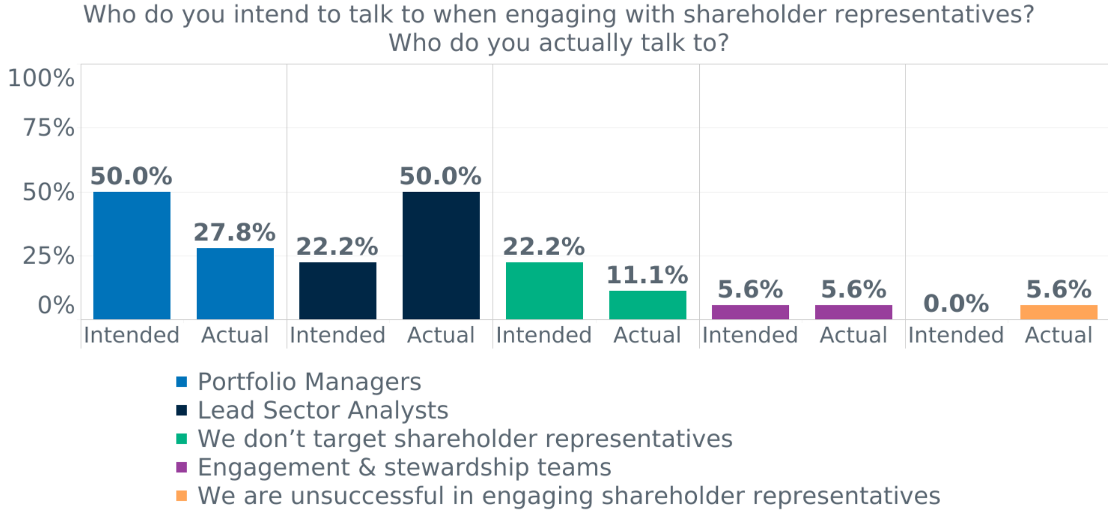


Investors primarily engage with the investor relations professionals at companies who are typically highly responsive and can communicate long-term strategies. Companies can use senior management and board time strategically to convey critical message or deeply understand investors' concerns.

Myth 3: Shareholders ask key questions during earnings calls

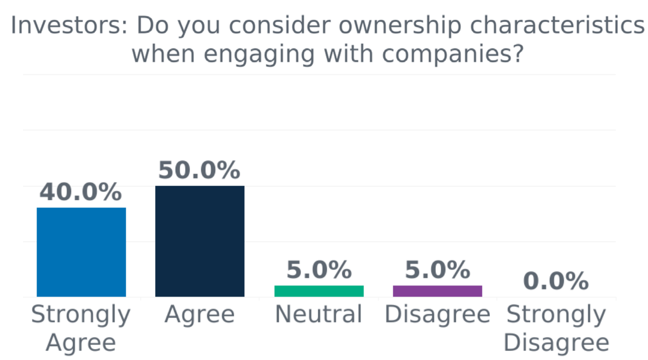
Fact: Most earnings calls questions are from less senior sell-side analysts and do not need senior management attention

3. **50% of corporations surveyed aim to talk to portfolio managers when engaging with their shareholder representatives, but only 28% of them actually do**



Corporations aim to engage with portfolio managers for one simple reason: they control whether to sell their stock position. Instead of portfolio managers, companies get directed to leader sector analysts, and engagement & stewardship teams. What matters for companies is to speak with sector analysts to explain strategy, engagement teams around votes, and directly with those who make the buy/sell decisions at key junctures.

4. **Only 50% of the companies proactively tailored their investors communications by investor type, even though 90% of investors consider who else holds the stock**



Communication and engagement efforts at companies are typically "one size fits all", resulting in homogenous, generic statements that fail to consider the specific priorities of the long-term shareholder block. On the other hand, investors are keenly aware of who the other holders of a company are when engaging with the company.

Myth 4: Companies have no influence over who holds their shares

Fact: Companies can tailor their long-term strategy to attract long-term shareholders through their engagements with investors

Building a more productive dialogue

Proactive investor-corporate communication ultimately drives long-term value creation. Given the analysis and results above, companies that leverage their long-term shareholder bases can build more support and resilience for their long-term strategy. From discussions with our corporate members and working group participants, we find that the companies with success in this area utilize the following tactics:

1. **Target long-term shareholders strategically.**
   - **Analyze their shareholder base.** This includes understanding who their long-term owners are (e.g. active hedge funds, passive index funds, pension funds, insiders, government).
   - **Understand trading patterns.** Specifically, why these shareholders own their stock (e.g. temporary price anomaly, mandatory holding as part of ETF, activist trying to drive change through a campaign), and what their priorities are when facing disruptions?
   - **Develop a segmentation strategy.** Companies need to treat the growth and cultivation of a long-term shareholder base as a key component of core business strategy, proactively shaping their shareholder base like they would segment their customers.
2. **Engage with their large, long-term shareholders, not with the "investment community."**
   - **Check-in with large, long-term shareholders consistently, not just during AGM season.** This includes proactively scheduling regular shareholder meetings with rather than waiting for AGM season or proxy season.
   - **Tailor communications and strategy to long-term shareholders.** Give less airtime to sell-side analysts, short-term shareholders, and potential/non shareholders.
   - **Use the CEO and board for meetings with key shareholders.** It is important to be responsive in addressing the strategic concerns of long-term shareholders. Bringing additional subject matter experts and top leadership to these meetings can be helpful. Conversely, provide lower levels of corporate access for non-shareholders or routine communications such as quarterly calls.
3. **Reward IR professionals for long-term shareholder success.**
   - **Align IR professional incentives with percentage of long-term investors.** Reward IR professionals for transforming shareholder bases to be more long-term via bringing in long-term shareholders aligned with their firm's long-term strategy.
   - **De-emphasize incentives related to sell-side interactions and rating.** These incentives are inherently short-term in nature and can create unwanted short-term pressures and an over-fixation on specific financial ratios.

Overall, a focus on financial and material matters in engagement efforts can unlock value for both investors and corporations.[19] Integrating long-term shareholder concerns into a consistent strategy and approaching the dialogue as a two-way conversation can deepen shareholder support for company strategies. Similarly, understanding more about a company's investors can provide the basis for tailoring an engagement strategy.

TOP QUESTIONS FOR COMPANIES TO ASK INVESTORS

The following questions are designed for companies to gauge the long-term orientation of a shareholder and determine investor motivations in order to tailor their engagements.

1. What is your investment thesis around our company?
2. What is your portfolio's average holding period?
3. Are your holdings representative of your economic exposure in our company (e.g. net of derivatives, short-selling)?
4. Does your fund engage in securities lending? If so, would you recall the shares in a vote?
5. What are your priority topics for engagement with your portfolio companies?
6. Do our current communication strategies and public disclosures provide sufficient insight for your needs?

Conclusion

Understanding a company's shareholder base can provide support for its long-term corporate strategy.

Our research has shown two things: first, that having a long-term shareholder base can unlock value for a company in the form of higher long-term ROIC, and higher CapEx, and R&D allocations.

Second, survey results indicated that there are serious disconnects between investors and companies in the engagement process, due to different shareholder objectives on the investor side and uncoordinated strategies on the corporate side.

Segmenting a company's shareholder base – and tailoring engagement strategies to long-term shareholders rather than the entire investment community - is the key to unlocking long-term value.

APPENDIX

Motivation for original data on share price and engagement experiences

Share price: To thoroughly understand the effects of corporate shareholder bases on financial and sustainability outcomes, we produced descriptive summary statistics and multivariate regressions to test the relationship between corporate shareholder bases and relevant ESG and financial metrics, as well as shareholder proposal success rates. Additionally, shareholder composition was classified into five institutional investor categories: the three based on the work of Bushee (1998), as well as government and insider categories.

The existing classification of underlying shareholder bases by type of investor:

- Brian Bushee's 1998 research first classified institutional investors into three groups: dedicated (long-term), transient (short-term), and quasi-indexers
- Long-term shareholders (pensions, SWFs) are often in it for the long-haul
- Indexed investors must own a restricted set of large companies (e.g. S&P 500)
- Short-term investors often seek to capitalize on a mispriced opportunity

However, previous studies in both share price and voting patterns have limitations:

- Bushee's work is only applicable to US companies and does not consider the influence of insider and government ownership
- Other studies are over a decade old, before environmental, social, and governance (ESG) issues became prevalent factors in both 'price' and 'vote' at companies
- Few studies examine the practical implications of a longer or shorter-term shareholder base, such as its impact on capital allocation decisions, ESG and reputation, and investor engagement.

Engagement experiences: To capture more of the investor/corporate cross function engagement experience, we conducted a survey – with similar questions posed to both companies and investors to identify pain points, inconsistencies, and gaps in the corporate vs. investor experience.

Demographics were as follows:

- Segment of value chain:
  - 52% work for an investor
  - 48% work for a public company
- Geographic Region:
  - 61% Americas
  - 21% EMEA
  - 18% APAC

- Size of organization:
  - 58% greater than 1,000 employees
  - 13% between 250-1,000 employees
  - 13% between 100-250 employees
  - 16% less than 250 employees

For a full list of survey questions and results, contact research@fcltglobal.org.

Limitations

- Our dataset was limited to large, public companies with available filing sources from proxies or shareholder reports
- Without data on investor engagements from both private and public sources, it is difficult to draw any firm conclusions about the relationship between shareholder base characteristics and the success or failure of past engagements from the investor side

Areas for further research (1-page call-out box spread)

- **Age of company:** companies that have been publicly listed for a longer period of time and have an established investor relations team may have more success when interacting with their investors.
- **Correlation between an investor's holding period and their tendency to vote with management:** activist investors often have shorter holding periods compared to other institutional investors[20], but it is unclear whether they are more likely to vote for or against management throughout the duration of their holding period.
- **Data limitations:** while our analysis examined the effects of a company's shareholder composition on various financial and sustainability metrics, it was limited to companies in the United States, Europe, and Canada. As economic growth and corporate valuations increase in the Asia Pacific region, it would be valuable to conduct a thorough analysis to understand the challenges faced by both investors and corporations in the investor-corporate dialogue in this region.

Shareholder classifications

Investment Style	Investment Horizon
GARP	Long-term
Index	Index
Core Value	Long-term
Growth	Long-term
Deep Value	Long-term
Core Growth	Long-term
Broker-Dealer	Short-term
Aggressive Growth	Long-term
Income Value	Long-term
Hedge Fund	Short-term
Specialty	Long-term
Mixed Style	Short-term
Yield	Short-term
Market Neutral	Short-term

Shareholder classifications (cont.)

Investment Style	Investment Horizon
Long/Short	Short-term
Global Macro	Short-term
VC/Private Equity	Long-term
Fund of Funds Hedge	Short-term
Momentum	Short-term
Sector Specific	Short-term
Statistical Arbitrage	Short-term
Convertible Arbitrage	Short-term
Emerging Markets Hedge	Short-term
Capital Structure Arbitrage	Short-term

For more information, please contact research@fcltglobal.org.

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ENDNOTES

[1]As defined by the largest 100 companies from the US, largest 100 European, and largest 50 Canadian companies in the MSCI All-Country World Index (ACWI) by year-end 2021 marketcap.

[2]Long-term shareholders here are defined as low turnover, non-index style investors based off Refinitiv's Ownership Shareholders Report page, originally taken from Bushee (1998). See Appendix for more details on shareholder classification.

[3]Usami, Jun et. al. "Japan 2022 Proxy Season." White & Case, 2022. https://www.whitecase.com/insight-alert/japan-2022-proxy-season.

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[15]Bauer, Rob, Jeroen Derwall, and Colin Tissen. "Private Shareholder Engagements on Material ESG Issues." SSRN Electronic Journal, 2022. https://doi.org/10.2139/ssrn.4171496.

[16]Edmans, Alex, and Clifford G. Holderness. “Blockholders: A Survey of Theory and Evidence.” The Handbook of the Economics of Corporate Governance 1 (2017): 541–636.

[17]Note: sample comprises of a static sample of the same top companies in each region by 2021 marketcap looking back to 2010, not largest companies each year. As such, data may me missing for companies newly public in the later years of our sample.

[18]Note: ESG controversy scores were collected from Refintiv. The ESG controversy score provides a comprehensive evaluation of a company’s sustainability impact and conduct over time. For full analysis results, contact research@fcltglobal.org.

[19]Bauer, Rob, Jeroen Derwall, and Colin Tissen. “Private Shareholder Engagements on Material ESG Issues.” SSRN Electronic Journal, 2022. https://doi.org/10.2139/ssrn.4171496.

[20]David A Hunker. “What Boards Need to Know about Shareholder Activism.” EY, 2021. https://www.ey.com/en_us/board-matters/what-boards-need-to-know-about-shareholder-activism.

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