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# STONE FROM THE TOP

Culture and strategy must be a twin focus for boards when engaging with investors.

Proactive and regular engagement with boards helps investors evaluate a company's culture, purpose and reputational risk. Thoughtfully-planned interactions between boards and investors have become critical, strategic exercises. They feed into how investors vote and should minimise the impact of opportunistic activism.

When we ask investors what their goals are when engaging with boards and management, most are focused on two things: understanding the company's business strategy and capital allocation and insight into how the board oversees corporate culture.

## Greater investor focus

Directors will continue to be judged on their competency, with investors also shining a spotlight on boardroom transparency. Among the many factors investors include in their assessment of individual board members, skills and independence remain critical factors. They also expect professional experience, followed by gender and ethnic diversity.

Investors also want boards to undertake regular and robust evaluations on their performance, either internally or by an external party. In line with the fourth edition of the *ASX Corporate Governance Principles and Recommendations* and the local appetite to assess whether a board is fit for purpose, the board skills matrix is becoming an important strategic tool to articulate director skills alignment with strategy and renewal.

## Non-financial measures emerge

Following Justice Kenneth Hayne's report subsequent to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, non-financial factors will become more

important for local investors when assessing company performance and corporate behaviour. Demand for information on aspects of a company such as culture is part of a larger global shift in expectations, rather than just being a local trend.

Financial services business BlackRock's chair, Larry Fink, is recognised as a leader in this movement. Last year, his annual letter to shareholders clearly articulated that for companies to prosper over the long term, they must deliver not only financial performance but also a positive contribution to society.

In Australia, global investor State Street sent a letter in January to directors of large, ASX-listed companies highlighting the importance of corporate culture, their accountability for culture and how this non-financial measure must be closely aligned with a company's overall business strategy. Undoubtedly, awareness and use of this measure in investment processes will continue to grow.

Boards can also expect more focus on the quality of disclosures and questions about managing climate risk.

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Fink's letter also highlighted greater awareness and mainstreaming of environmental, social and governance (ESG) factors when it comes to determining the value of a company. Recently, a significant number of local investors and boards have put these factors front of mind.

When we ask investors about the most important sustainability topics to them, climate change is number one. This is seen in the groundswell of investor support for reporting under the Task Force on Climate-related Financial Disclosures (TCFD). Furthermore, investors want more detailed information about human capital management, reinforcing investor focus on social risk management and its impact on financial performance.

## Looking ahead

Institutional investors are now clearly communicating they will use their sizeable voting power to hold directors accountable when they believe response to and progress on governance issues they consider important is either insufficient or too slow. They are also increasingly using regular engagement to monitor and drive change at board level.

Investors will continue to focus on understanding the alignment between board composition and business strategy and how the board oversees corporate culture.

The shift of investor attentions from a company's compliance with corporate governance codes to sustainability-related principles is going to have an impact in the future well beyond proxy voting to engagement strategies and investment decisions.

The effects of this shift are something we will continue to watch while helping companies navigate this changing environment.