Shareholder Activism and Encana's Headquarters Relocation

Organization: Encana

By: Mikenna Ritchie

Issue Summary

In a news release dated October 31, 2019 (Encana Corporation, 2019a), Encana announced their intention to relocate their headquarters to the United States. It was later announced this location would be in Colorado. Encana's decision to relocate their corporate domicile to the United States in 2020 has not been taken lightly by Calgarians and most specifically, their shareholders. A long-standing, Calgary-based company, Encana employs more than 2,500 people with over 40 per cent of staff based in Canada (Stephenson, 2019). However, due to the ongoing energy exodus and tumultuous market in Alberta, more companies are finding themselves in dire need to relocate to more reliable markets, like Colorado and Texas (Flexhaug, 2019).

While this is a recent and on-going change to the organization, notable effects have already been seen. The announcement of relocation has caused a continuous downward fluctuation in their share price. According to BNN Bloomberg (Orland, 2019) and per Letko, Brosseau & Associates Inc. (2019), "Encana shares have declined by approximately 70% since September 2018", when Encana began making organizational changes that signified their intentions to relocate to the United States.

SWOT Matrix

Strengths	Weaknesses
1. Exposure to U.S. Market 2. Unaffected Canadian staff 3. Majority of operations already based in U.S.	1. Shareholder activism 2. Relocation costs 3. Loss of Canadian identity via name change and relocation of HQ.
Opportunities	**Threats**
1. Lower taxes 2. Less regulations 3. Trade on NYSE 4. Access to new investors 5. Expansion of practices.	1. Dropped stock price 2. Shareholder approval 3. Court Approval 4. Stock exchange approval 5. Trade war with China.

Strengths

Encana intends for the relocation to offer greater "exposure to the significantly larger U.S. market and funds is estimated to create more than $1 billion of additional demand" (Encana Corporation, 2019c). Multinational corporations (MNCs) typically decide to "move to locations that are more attractive (in terms of industrial agglomeration and a favorable business climate) than the host country" (Birkinshaw, Braunderhjelm, Holm, & Terjesen, 2006), which appears to be Encana's main reason for moving to the U.S., as Encana (2019c) has stated that nearly 80% of their current operations are based there as of 2018.

Encana's CEO, Doug Suttles, is confident that "[t]here'll be no movement of roles or responsibilities, no reduction of staff and actually no change as to how we're allocating capital"

(Stephenson, 2019, para. 6). Suttles also confirmed current Canadian staff would remain relatively unaffected by the move and not expected to relocate to keep their jobs. This was a major concern to employees at the time of the announcement as “such decisions generally entail major layoffs and restructuring initiatives” (Bhabra, Lel, & Tirtiroglu, 2002, p. 349).

Weaknesses

The weaknesses associated with Encana's intention of relocating include relocation costs, affected morale and shareholder activism. Relocations are often driven by opportunities to save, however, if not done strategically, "cost savings associated with relocation may be less than the costs to actually relocate" (Wagner, 2016). It's critical that Encana keep this in mind throughout the relocation process, especially as they're still intending on maintaining their Canadian based operations for the foreseeable future, even once the HQ is redomiciled.

Encana's intention to redomicile has been faced with pushback from major investors. Encana's announcement has sparked an outcry of shareholder activism. Shareholder activism is defined as "a person who attempts to use his or her rights as a shareholder of a publicly-traded corporation to bring about change within or for the corporation" (Chen, 2019). Letko, Brosseau & Associates Inc., a Canadian investment management firm who have "control or direction over approximately 4.0% of the outstanding shares of Encana Corporation" (Letko, Brosseau & Associates Inc., 2019) are rallying other shareholders to vote against the relocation. Although it may come across as an external threat, shareholder activism against Encana's relocation is a weakness as the shareholders are considered an internal public of the organization.

Letko, Brosseau & Associates Inc cite many reasons the relocation is not in the best interest of shareholders, including:

> the potential loss of 186 million shares held by index funds and the possible loss of both 100 million Canadian taxable investor shares and 155 million institutional shares sums to a potential negative impact of up to 441 million shares, far in excess of the potential 250 million shares from the company's estimated billion dollar incremental demand. (Letko, Brosseau & Associates Inc., 2019)

These losses would ultimately have a drastic impact on the stock price and earnings for Encana and their shareholders.

Opportunities

The relocation provides Encana copious opportunities, which is likely why they have decided to relocate in the first place. Some of these opportunities include penetration into a new market, the chance to expand business practices into new areas and therefore grow the organization, access to US capital and investors as well as deeper trading on the NYSE.

Encana's decision to relocate their corporate domicile to the United States presents many opportunities for the organization. While based in Canada, specifically Alberta, Encana has been struggling to maintain a competitive advantage in the energy and power industry. Lammam and MacIntyre note that Canadian-based MNCs are struggling for many reasons, some of which "includes higher tax rates on personal income, corporate income and payroll; persistent budget deficits, which risk future tax increases; new regulations on carbon, resource projects and labour; and higher costs of doing business through minimum wage and energy price hikes" (Lammam & MacIntyre, 2018). In leaving behind the carbon taxes and budget deficits, Encana will benefit from the U.S.'s lower corporate taxes and access to a new pool of capital investors.

While Canada once had a competitive advantage over the U.S. for Encana's headquarters, now "more than 80% of Encana's capital investments, 75% of revenues and approximately 70% of proved reserves are located in the U.S." (Encana, 2019c). Lammam and Macintyre (2018) say the advantage Alberta had was lost in 2018 and the biggest impact was the US reforms under President Trump; "Reforms south of the border lowered the federal statutory corporate income tax rate from 35 per cent to 21 per cent, allowed immediate expensing of capital investment, and created incentives to move overseas profits to the U.S" (Lammam & Macintyre, 2018). As a cost driven approach to relocation, Encana sees far more. Many other MNCs are considering a similar approach with regard to relocation. While there may be costs and other weaknesses associated with the move, they're outweighed by the opportunities the relocation is predicted to provide Encana and their shareholders.

Threats

Understanding the threats associated with entering a new market will be crucial for Encana to have a competitive advantage upon entry. However, there are also threats that could impede the relocation altogether. "In addition to shareholder approval, stock exchange and Canadian court approvals are also required" (Encana Corporation, 2019c) before Encana can officially relocate to the U.S. This means the shareholder activism has the opportunity to influence the media and possibly impede both the courts and stock exchange from approving this move.

Many believe the relocation is in the interest of CEO Doug Suttles, an American, who upon his appointment in 2013, swiftly "set about selling Canadian assets and building a major position in the U.S." (Stephenson, 2019) by purchasing and acquiring multiple U.S. companies. Evidence shows that a "relocation decision motivated by managerial self-interest experience significantly negative abnormal returns" (Ghosh, Rodriquez, & Sirmans, 1995), whereas "relocation announcements motivated by cost savings is significantly positive" (Ghosh, Rodriquez, & Sirmans, 1995). The public media have interpreted the relocation as self-intrinsic for Suttles and this has resulted in a drop of their share price in the two months since being announced.

Another widely expressed concern of the relocation is the current state of the E&P industry in the U.S. under President Donald Trump's ongoing trade war with China. Robert

Rapier (2019) says there are many concerns with Trump's trade and tariff war with China that impact U.S. based oil companies. Due to Trump's threats "the markets were broadly impacted, but the energy sector was hit especially hard. Crude oil prices suffered their largest drop in over four years" (Rapier, 2019). And while we haven't hit a recession yet, Rapier has seen notable impacts of the trade wars on the industry. The trade wars have impacted the industry in two other ways, Rapier says, "The oil industry is capital intensive, and some of that capital equipment comes from China" and "China stopped buying U.S. crude. They turned instead to Iran for their crude oil needs" (Rapier, 2019), both as a result of the trade war and both significantly impacting the U.S. oil market. This is a major and ongoing concern for Encana's shareholders, as it threatens the stability of the stock price.

Recommendations

The stakeholder and shareholder perception of Encana's relocation is crucial in how information is further disseminated as the situation continues. A mentioned threat is the move opposing the self-interest of Encana's CEO, Doug Suttles. Additionally, the evidence that strongly suggests Canadian corporate relocations are more often than not followed with changes to employment have both stakeholders and shareholders concerned with the impact. With that, it is recommended that Encana Corporation focus on reiterating the value of Encana's Canadian roots and offer clear information about how and if employment will be affected. Furthermore, Encana will need to focus on emphasizing the advantages of relocation to shareholders, as they're the ones with, objectively, the most at stake.

Communication Plan

The communication plan is intended to reach internal stakeholders and shareholders. Primarily employees and shareholders/investment groups. All of the recommendations will best be fulfilled through the appropriate communication strategies and channels. The primarily affected group of the threats and weaknesses of the relocation are internal (shareholders and employees), with that, the communications channels chosen should be ones that reach internal publics most effectively. For example, an internal newsletter, shareholder conference call or news release. The key messages to focus on are the value of the relocation to shareholders, via investor relations, the unaffected employment/employee retention and overall benefits of the U.S. market compared to Alberta's. Moira Conlon (2016) says that communicating to investors is highly effective when an organization "turn(s) the bad news into good news by communicating how you addressed a challenging situation and moved beyond it. Take credit for positive outcomes. This will help shore up credibility" (Ferracone, 2016). Shareholders need to re-establish trust in Encana as they transition to a U.S. HQ and to do so, they should remain transparent throughout the approval process.

It is proposed that Encana utilize an open conference call for shareholders with the board that has a question and answer period. This way, shareholders can voice concerns, ask questions and get immediate responses. Encana should publish a news release to announce the conference call to stakeholders and shareholders to provide information for how it can be accessed. An additional communication product could be a social media post that briefly touches on Encana's Canadian roots and re-iterates there is no intention to change the Canadian operations of the company. This would be an important public relations strategy to restore consumer faith, alleviate doubts and ensure transparency with their intentions. The news release to announce the conference call is a communication strategy targeted directly at shareholders, who have been the most vocally opposed group regarding the relocation. By having a two-way channel of communication focussed on investor relations, Encana aims to restore faith in the organization.

In targeting the general public through a social media post, Encana can control their narrative and dispel any misinformation or worry circulating about the status of Encana in Canada. Both these tools are strategic for Encana to be representatively transparent and honest with stakeholders and shareholders, a key to surviving any negative attention from shareholder activism against the relocation.

References

Bhabra, H.S., Lel, U., & Tirtiroglu, D. (2002). Stock Market's Reaction To Business Relocations: Canadian Evidence. *Canadian Journal of Administrative Sciences, 14*(4), 346-358. Retrieved December 12, 2019 from https://onlinelibrary.wiley.com/doi/epdf/10.1111/j.1936-4490.2002.tb00280

Birkinshaw, J., Braunerhjelm, P., Holm, U., & Terjesen, S. (2006). Why Do Some Multinational Corporations Relocate Their Headquarters Overseas. *Strategic Management Journal, 27*(7), 681-700. Retrieved from http://www.jstor.org/stable/20142366

Chen, J. (2019, November 18). Shareholder Activist Definition. Retrieved December 8, 2019, from https://www.investopedia.com/terms/s/shareholderactivist.asp

Encana Corporation. (2019a, October 31). Encana to Establish Corporate Domicile in the U.S. *Cision.* Retrieved from https://www.newswire.ca/news-releases/encana-to-establish-corporate-domicile-in-the-u-s--845271326.html

Encana Corporation. (2019b, December 11). Encana Files Definitive Proxy Statement/Prospectus. *Cision.* Retrieved December 11, 2019 from https://www.newswire.ca/news-releases/encana-files-definitive-proxy-statement-prospectus-844870788.html

Encana Corporation. (2019c November 19). Encana Issues Response to Letko Brosseau's Release on Company's Establishment of Domicile in the United States. *Cision.* Retrieved December 12, 2019 from https://www.newswire.ca/news-releases/encana-issues-response-to-letko-brosseau-s-release-on-company-s-establishment-of-domicile-in-the-united-states-821929309.html

Flexhaug, Dallas. (2019, December 4). Energy exodus: oil and gas workers look for more opportunity in Texas. *Global News.* Retrieved December 11, 2019 from https://globalnews.ca/news/6234607/energy-exodus-oil-and-gas-alberta/

Ferracone, R. (2016, May 3). How To Best Communicate With Shareholders. *Forbes*. https://www.forbes.com/sites/robinferracone/2016/05/03/how-to-best-communicate-with-shareholders/#647fdee85c19

Ghosh, C., Rodriquez, M., & Sirmans, C.F. (1995). Gains from Corporate Headquarters Relocations: Evidence from the Stock Market. *Journal of Urban Economics, 38*, 291-311. Retrieved December 11, 2019 from http://sbuweb.tcu.edu/mrodriguez/research/ReloJUE.pdf

Lammam, C., & MacIntyre, H. (2018, May 4). *Canada has completely lost its business tax advantage over the US.* Retrieved from https://www.fraserinstitute.org/blogs/canada-has-completely-lost-its-business-tax-advantage-over-the-us

Letko, Brosseau & Associates Inc. (2019, November 28). Letko Brosseau Reiterates it Will Vote Against Encana's Proposed Exit From Canada. Retrieved December 12, 2019 from https://www.newswire.ca/news-releases/letko-brosseau-reiterates-it-will-vote-against-encana-s-proposed-exit-from-canada-823827726.html

Orland, K. (2019, November 20). Encana disappointed after investor blasts plan to redomicile. *BNN Bloomberg*. Retrieved from https://www.bnnbloomberg.ca/encana-disappointed-after-investor-blasts-plan-to-redomicile-1.1350405

Rapier, R. (2019, August 25). How The Trade War Impacts The Oil Industry. *Forbes.* Retrieved December 12, 2019 from https://www.forbes.com/sites/rrapier/2019/08/25/how-the-trade-war-impacts-the-oil-industry/#608de7a5ed29

Stephenson, A. (2019, October 31). 'A tragedy for Canada': Encana shift to U.S. seen as another blow to morale in Alberta. *Calgary Herald.* Retrieved December 12, 2019 from https://calgaryherald.com/business/calgary-based-encana-plans-to-move-base-to-u-s-amid-pipeline-crunch

Wagner, L. (2019, March 10). Why Corporate Headquarters Relocate. Retrieved December 15, 2019, from https://www.tradeandindustrydev.com/industry/why-corporate-headquarters-relocate-11394.