How Not To Become A Shareholder Activist Target

Law360, New York (June 30, 2014, 10:31 AM ET) -- Shareholder activism is the corporate topic du jour, be it in boardrooms, the media or Washington, D.C. While corporate boards and management need to understand the current environment and how we got here, their top priority is to develop comprehensive strategies for navigating the activism landscape. As activists have become more sophisticated, and activism more mainstream, approaches to dealing with activists are, by necessity, evolving.

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Key Factors Driving Activism

The economic and market landscape is perhaps more favorable to activism today than at any time in the recent past. The aggregate dollars invested in the activist asset class have continued to grow, providing large amounts of capital to established funds that are able to take bigger stakes and target larger companies as well as spawning a slew of new funds needing to prove their activist credentials.

The views of traditionally passive "long" institutional shareholders toward shareholder activism have evolved to be more sympathetic, with these institutions more frequently providing support to activist campaigns — generally behind the scenes but sometimes in the open. Governance trends, including the dismantling of structural defenses such as classified boards and shareholder rights plans, the advent of majority voting standards in director elections and the increasing prevalence of shareholders' ability to call special meetings or act by written consent, have increased the pressure on directors of companies targeted by activists.

At the same time, activists have become more sophisticated in identifying their platforms and running their campaigns — often generating significant positive attention from mainstream media. The result of all this has been the creation of an environment where even large, well-performing companies can become targets of activist campaigns.

Practical Considerations for Companies

In response to the changing landscape, public companies have become more sophisticated in preparing for activism and in their interactions with institutions and activists. Companies have begun to periodically review their businesses and strategies with an eye on platforms that could be pursued by activist investors, identifying potential vulnerabilities. They are augmenting efforts to engage with institutional investors to build a better understanding of shareholder views and showing greater openness to dialogue with activist investors. Finally, companies are becoming more savvy in engaging with the media and in other communications strategies to proactively achieve favorable outcomes.

There are a number of measures companies can consider when devising strategies to reduce risk of becoming a target of an activist and encourage greater preparedness, including:

Self-Evaluation. Today's activist agendas are more diverse than those of the past. Short-term, event-driven platforms are not the only devices in the activist toolkit. Activists today may agitate over business strategy, operations and management compensation, as well as more traditional items such as the sale of the company or its assets and the return of capital through dividends or stock purchases. Accordingly, public companies should regularly evaluate their businesses, assets, operations and strategy to identify potential vulnerabilities to activism.

By viewing themselves through the lens of a theoretical activist, companies can identify and consider the pros and cons of potential alternative strategies on a timetable that is not constrained by the exigencies of a proxy campaign. This self-evaluation can in turn inform board and management decisions on strategy, as well as facilitate development of messages to shareholders regarding corporate priorities and approach.

Most directors and officers today recognize that healthy stock performance, while helpful, is no longer sufficient to avoid activist attention, as activists increasingly challenge governance provisions, capital allocation policies and other features of even well-performing companies. This self-evaluation, together with keeping a close eye on the company's shareholder base, is a key element of corporate advance preparation for dealing with activism.

Shareholder Engagement. Companies have come to recognize the need to engage with their institutional investors on a regular basis, not just in the context of a proxy fight. Such regular engagement provides an opportunity to communicate board and management vision for the company and serves as an "early warning" system for identifying nascent shareholder unhappiness with corporate performance and shareholder views on strategic, financial and governance matters.

Many institutional investors share directors' concerns over the implications of strategic or financial programs overly biased toward short-term gain at the expense of long-term growth. Building a relationship of trust and understanding with significant shareholders can also help displace proxy advisory firms as the arbiters of good governance practices and "shareholder-friendly" policies.

Activist Engagement. It once may have been possible to refuse to meaningfully engage with an activist stockholder based merely on the activists status as such, but that day has passed. Over time, institutional investors increasingly have come to view activism as more mainstream, and have developed an expectation that boards and management will seek "constructive engagement" with activists.

As SEC Chairwoman Mary Jo White said recently, "[i]t was not long ago that the 'activist' moniker had a distinctly negative connotation ... today, there is widespread acceptance of many of the policy changes that so-called 'activists' are seeking to effect." It is axiomatic that ideas should be judged on their merit and not on the identity of their proponent, and a target's defense of leveling a general criticism of an activist's short-term focus is not likely to be compelling to investors.

Shareholders want to see that directors and management have responsibly considered bona fide proposals made by activists. Meeting with an activist to discuss its proposals can help to show that the company is appropriately responsive, as well as provide additional information regarding the activist's ideas and intentions.

Implementing a Communications Plan. Activists have been successful in leveraging both traditional and social media to pressure the companies they target. As they have targeted larger companies, activists have attracted the attention of traditional media outlets, with individuals such as Bill Ackman and Carl Icahn regularly appearing in the financial media to discuss the merits of their latest positions and campaigns. But activists also are leveraging social media to broadcast their messages, such as Carl Icahn's frequent use of Twitter in recent campaigns against Apple, Dell and eBay.

In addition to articulating a credible and coherent strategy for creating long-term shareholder value, companies need to be adept at dealing with both traditional and social media in responding to an activist campaign; while the media doesn't vote in a corporate contest, they can have an impact on investor (particularly retail investor) perception and sentiment. Companies should be aware of and comply with all the nuances of applicable securities laws and recognize that, in certain areas, they may be frustrated that the activists may not be subject to all of the same constraints the company faces.

Understanding the Alternatives. As a result of growing support for activists among institutional investors and the propensity for proxy advisory services to support candidates nominated by activists, especially in "short slate" situations (i.e., where dissidents solicit proxies to support nominees who, if elected, would make up a minority of the board), companies are finding proxy contests more challenging to win. As a result, settlements of threatened proxy contests by activists are becoming more common as companies seek to avoid the risks and uncertainty of a proxy fight.

There can be meaningful benefits to settling a proxy fight, including avoiding the cost and distraction of a lengthy fight and negotiating an outcome that is more palatable to the board than the outcome if the fight is lost. At the same time, the decision to pursue a settlement should not be reflexive given the potential concerns that might arise from pursuing the activist's agenda or from having activist representation in the boardroom. Directors facing a proxy fight or other activist campaign have alternatives, and the approach to any specific situation must be informed by the particular facts and circumstances. Sometimes it makes sense to settle, and sometimes it makes sense to fight.

Do the Right Thing. Directors facing a proxy fight or other activist campaign have a fiduciary duty to act in a manner that the board believes is in the best interests of the company and its shareholders under the circumstances — not to simply respond in a Pavlovian manner to perceived shareholder sentiment at a moment in time.

Directors should be active and engaged participants in considering both the merits and detriments of activist proposals and, having formed a view, seek to achieve the outcome that they believe is in the best interests of the company and its shareholders. This is not to say that directors in determining a course of conduct should ignore investor sentiment or estimates of success in a fight — all relevant factors should be considered. But directors need not and should not merely passively adopt an activist's agenda based only on perceived shareholder sentiment at the time.

Shareholder activism is not going away anytime soon, and the strategies to deal with activism need to evolve in response to the current environment. Companies should continue to take the preparedness steps contained in the various checklists prepared by advisers. But more importantly, companies need to pursue a customized shareholder engagement program and communications strategy, address shareholder concerns and respond to activist proposals on their merits. These and other measures will ensure that companies are well-prepared in the event an activist surfaces.

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