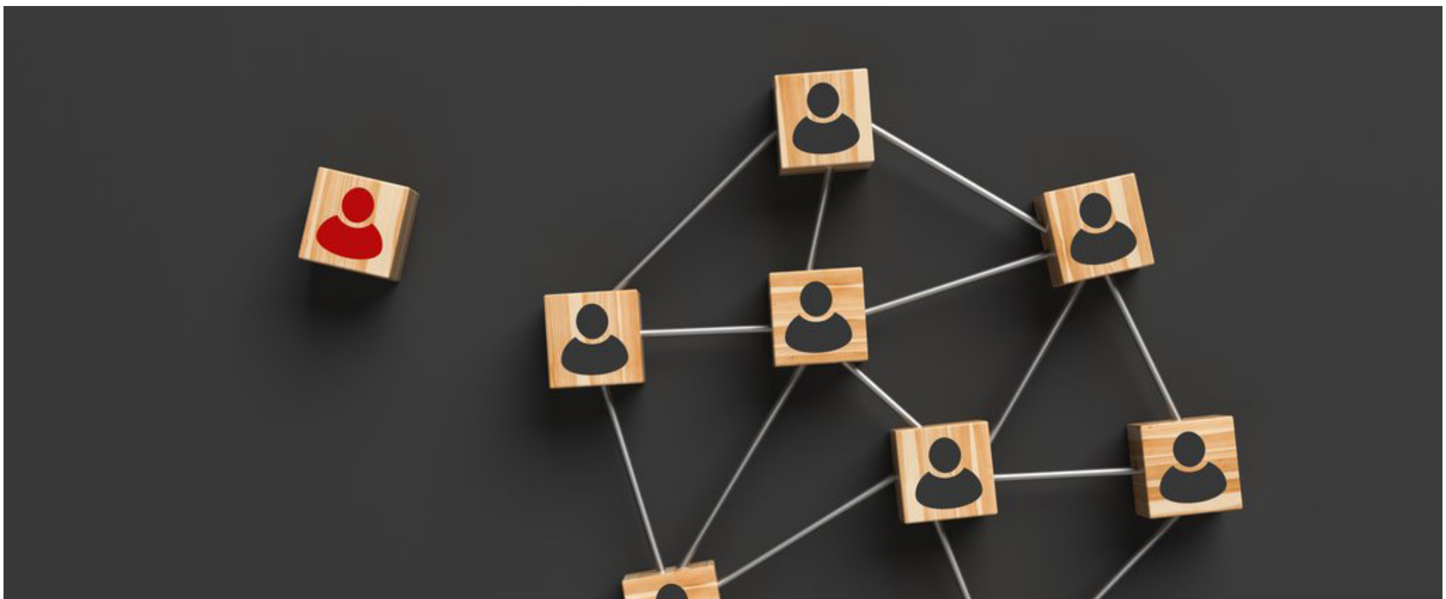
SILICON VALLEY
BUSINESS JOURNAL

How to deal with shareholder activists: An open letter to corporate CEOs and founders



Companies are facing what are known as activity investors who accumulate a significant amount of shares of a company and who try to influence them.

BY DEREK ZABA
Contributor

Dear public company CEO/founders,

Over the past decade, shareholder activism has become a permanent part of the landscape for public companies.

Last year, Silicon Valley was a particular hotbed for shareholder activism, and activists haven't let up with their focus on tech companies in 2023. Conditions have been ripe: valuation multiples have compressed in many subsectors as investors have quickly shifted demands from "growth" to "profitable growth."

As corporate leaders, you probably have a lot of questions. Let me offer some perspective.

Can shareholder activism happen to me? Well, if your company is one of those rare juggernauts whose stock price is consistently up and to the right over the long term, then you can safely skip this article and shift your focus towards deciding what you'll launch into space when you retire. For everyone else, potential shareholder activism is a matter of "if" not "when."

Founder-led companies in the Bay Area are particularly caught in the crosshairs, with several activists specifically targeting founders as part of their screening methodologies. Even companies with dual class share structures or large insider ownership stakes common in tech companies have not been insulated from activism.

What do I need to know? It is crucial to understand that large institutional investors, not activists, hold the keys to the kingdom. Most activist stakes are typically under 10%, well short of what is needed to unilaterally force a company's hand. Thus, the power of an activist derives not from their own stake but from their ability to convince other shareholders to support their case for change.

Derek Zaba is partner in the Palo Alto and New York offices of Sidley Austin LLP where he is co-head of global activism defense and head of tech activism defense practices.

Image: Sidley

Will my other shareholders support an activist campaign? The bad news is that activism rarely arises unless an activist believes they can garner support from other shareholders. In some cases, a shareholder may invite the activist into the stock in what's known as a "Request For Activist" (RFA). Additionally, companies targeted by activists are almost always facing challenges in their business. As a result, the activist will undoubtedly include critiques that resonate with many of your shareholders.

The good news is, even if the broader shareholder base shares the activist's critiques, there are frequently discrepancies in the remedies proposed by an activist versus what is desired by the "average" shareholder. Activists generally have shorter time horizons than the average institutional investor. They are generally the first to call for a sale of the company, the termination of the CEO, slashing R&D, gutting SG&A or other dramatic changes.

Just because a company is underperforming doesn't necessarily mean it's time for a strategic shift, let alone selling the company or changing out the board of directors. Much depends on the reason for and degree of underperformance, as well as the actions taken by the board and CEO to address the underperformance.

So, *what do my shareholders want?* Ask them. The shareholder base is not monolithic in their perspectives. But what they have in common is they all want performance…obviously. And when a company underperforms, shareholders want a team that they believe will address the issue.

There's one last question you probably have: What does this mean for me?

- **Build the longest runway possible to execute your plan:** Every company will occasionally experience speedbumps. Ensure that shareholders understand your strategy and identify potential speedbumps in advance as you execute that strategy. Seek to understand the perspectives and incentives of your broader shareholder base and include their input when making key decisions.
- **Be prepared:** Activists have the ultimate tactical advantage of choosing whether and when a campaign will take place. Accordingly, they can be fully prepared when they launch a campaign. Ensure that the board and senior management are also prepared for the day an activist arrives.
- **Stay focused:** While I'm sure you're already working your hardest to ensure performance, the arrival of an activist can create disruption and distraction amongst employees and customers at exactly the wrong time. Keep your teams focused on execution.
- **Choose your battles:** If the remedy proposed by an activist would be broadly supported by your other shareholders, then it's best to find an amicable resolution. However, if you believe there is a divergence, then it may make sense to put the decision in the hands of your shareholders.
- **Trust those who know the process:** The process for resolving board disputes (the proxy contest) is not intuitive. This is what activists do full time, but it is often the first time for a company. Successful founders have achieved success by trusting their instincts in the face of naysayers. Understand that the instincts you relied upon to help build the company may not serve you as well in the uncommon battlefield terrain of a proxy contest.