

PREPARING FOR AN ACTIVIST INVESTOR

What boards need to know to navigate shareholder activism.

By Jessica Wood, Derek Zaba and Kai H.E. Liekefett

FROM A TACTICAL PERSPECTIVE, activists have the ultimate advantage: they get to choose whether and when a campaign will take place. Inevitably, they are prepared when they choose to launch. Target companies, on the other hand, begin campaigns on the defensive. Therefore, it is paramount that companies properly prepare for activism before an activist arrives to help level the tactical playing field.

Strategy

The best defense against shareholder activism is a clear strategy that is well-articulated to shareholders, executed deftly and evidenced by financial and operational performance. When considering significant strategic and operational decisions, it is often helpful to consider how an activist would view those decisions. If the board's desired path is a common theme in activism campaigns, then it's helpful to ensure the rationale for the decision is sound, pressure-tested and can be effectively conveyed to shareholders.

Engagement with Shareholders and Other Stakeholders

Building rapport with a company's shareholders provides a number of benefits, particularly in the event of a proxy contest. Having a strong history of engagement and building credibility across types of shareholders can be critical if an activist emerges. It is important to understand that shareholder bases are not monolithic—index fund and quantitative investors have different perspectives than long-only investors and hedge funds. Even within those broad categories, individual investors often have different preferences. Research demonstrates that shareholder engagement is associated with increased shareholder confidence in management and the board, as well as a lower likelihood of activism. When companies do experience activism, those with greater engagement have less costly campaigns.

The company should also work toward cultivating strong relationships with other important third-party constituents, such as analysts,

proxy advisory firms and the media, who can play an important role in a proxy contest. The media often has a strong, preexisting relationship with activist firms, so it is important to level the playing field during peacetime by establishing similar connections with the company.

Effective contingency plans include implementing early warning systems that will detect the arrival of an activist and identifying a team of advisors.

Board Composition and Corporate Governance

Board composition and corporate governance should be a key focus for the board during peacetime. Every company will have stumbles from time to time, and when that occurs, governance will be brought into sharp focus. Any governance vulnerabilities will be exploited by an activist as part of their broader campaign. Therefore, it is important to regularly review the company's governance profile and practices to ensure that they consider the perspectives of the company's shareholder base and are well-tailored to the company's circumstances.

Board representation is the ultimate leverage point for an activist. Activists will target any vulnerabilities in the board's overall composition, structure or practices, as well as any individual director vulnerabilities. While refreshment and tenure are the most obvious targets, activists will also aim at skills, experience and background if they do not align with the activist's views of what the boardroom requires. The board should objectively assess its own composition on a regular basis to ensure that they reflect the right mix of background and perspectives necessary to oversee the company's strategy and management.

Contingency Planning

It is beneficial to be thoughtful about contingency

planning for activism, similar to other potential high-impact crisis situations. Effective contingency plans include implementing early warning systems that will detect the arrival of an activist and identifying a team of advisors that would shepherd the board and management through an activist campaign

should one arise. It is helpful to create a "break the glass" response plan for the most likely contingencies, particularly in the case of an "ambush" public attack with no prior warning. Annual tabletop exercises with key advisors to simulate various activist scenarios are also helpful. Additionally, the company should consider the placement of a shareholder rights plan on the shelf in case an activist or other hostile party begins to rapidly accumulate a stake in the company.



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