

# CORPORATE BOARD MEMBER®

## SURVIVING ACTIVIST SHAREHOLDERS, PASSIVE INDEX FUNDS AND CORPORATE CRISES

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WHEN IT COMES TO THE UNIQUE challenges facing directors today, it is safe to say that “we’re not in Kansas anymore”. A look back at the first half of 2018 shows that shareholder activism continues at record pace, passive asset managers are growing larger and have found their ESG-centric voice, and corporate crises (from cyber breaches to #MeToo-driven executive exits) are proving to be fast-moving and wide-ranging.

Successfully addressing these complex and often competing challenges requires more than ever that boards be well informed and prioritize advance preparation. To that end, boards should focus on the following issues to best position themselves to successfully navigate this new era:

**Constructive Offseason Engagement with Significant Shareholders.** Pursue proactive “offseason” engagement with large institutional investors, including managers of large index funds, such as BlackRock, Vanguard, and State Street. While they may not always be responsive to outreach, even the attempt can contribute to the relationship. Make sure you articulate clearly the topics you would like to discuss with them, rather than just proposing a meeting/call. Often, discussions with passive managers will be centered more on long-term strategy, governance and other ESG matters tied to long-term success than those with active managers, who will be more focused on financial performance and operations.

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**Refresh Disclosure.** Evaluate current investor communications materials and SEC disclosure with a fresh eye to ensure that the company's strategic direction and business case, as well as risk factors and challenges, are clear to investors and match current strategic priorities.

At the same time, evaluate whether the current disclosure mirrors the metrics the company's large investors are using to evaluate the company, and supplement as appropriate. In addition to helping shareholders better understand the strategic direction, communicating to the market about board strategy on a "clear day" in a similarly rigorous fashion as would be deployed in a "fight deck" in the event of a proxy contest will enhance the credibility of the board's case in the "heat of battle". Reactive and new messaging and metrics deployed in the midst of a proxy contest will lead institutional shareholders to wonder why they are receiving the board's true views on performance or strategic direction for the first time in a fight.

#### **Replenish the Activist Response Toolkit.**

Structural defenses to activism and hostile takeovers should be updated regularly to reflect state-of-the-art tools and caselaw developments while taking into account potential investor relations consequences. The board should be familiar with the key provisions of its "shelf" poison pill and ensure that it is "trigger-ready" in the event it needs to be quickly deployed. Maintaining high quality stock surveillance is also critical – the resulting visibility can make the difference between being able to initiate constructive engagement with an activist as compared to negotiating the terms of surrender after an ambush.

Boards and senior management teams should also have the benefit of practice exercises that simulate both constructive and aggressive activist engagement and ensure regular self-evaluation through a critical lens. By anticipating and proactively addressing vulnerabilities, a company can stave off or minimize the risks of activist attacks.

**Establish Crisis Response Protocol.** This past year has shown that not all corporate crises come in form of an activist shareholder launching a public attack. Boards can avoid appearing flat-footed by preparing for a broad variety of potential corporate crises by putting in place measures to anticipate and mitigate risk while also preparing a comprehensive response protocol. The reputational impact of a major corporate crisis such as a cybersecurity breach or allegation of sexual misconduct by a senior executive is amplified by the fast-moving nature of social media and can lead to significant market value loss, consumer boycotts, customer/supplier issues, and shareholder litigation. The best way to help ensure a coordinated and streamlined response to a myriad of potential situations is to game plan ahead of time with experienced crisis advisors.

A manageable problem can blossom quickly into a full-blown emergency if the initial void is filled with knee-jerk reactions in press releases, leaks or off-hand comments to reporters. Incomplete or premature responses could further destabilize an organization already on its back foot and may even contravene securities laws or other regulatory frameworks and create more legal risk. With proper planning and counsel, press releases, talking points and other communications in response to a crisis can be coordinated, formulated and vetted by key decision makers before any substantive response is finalized, thereby simultaneously supporting and enhancing both the company's reputational and legal strategies. Compliance programs and policies should also be updated to lessen the risks of a crisis occurring and to ensure that any response complies with both law and common sense.

Directors today face a world where a crisis can come from any number of directions and spread like wildfire. Boards can minimize the risk that a crisis becomes a disaster by taking advantage of "clear days" to proactively address risks and potential responses.