June 11, 2018

Board Ready: Shareholder Activism, Corporate Governance and
the Hunt for Long-Term Value

** A modified version of this article was recently featured in a publication for public company directors, CEOs and GCs.*

As the spotlight on boards, management teams, corporate performance and governance intensifies, as articles like the Bloomberg and Fortune profiles of Elliott Management ("The World's Most Feared Investor—Why the World's CEOs Fear Paul Singer" and "Whatever It Takes to Win—How Paul Singer's Hedge Fund Always Wins") and other activist investors become required reading in every boardroom and C-suite, and as activist campaigns against successful companies of all sizes increase worldwide, below are fifteen themes expected to impact boardroom, CEO and investor behavior and decision-making in the coming years.

1. **The CEO, the Board and the Strategy.**
2. **Activism Preparedness Grows Up.**
3. **Companies Standing Up, Playing Offense and Showing Conviction without Capitulation.**
4. **Activists Standing Down.**
5. **"Shock, Awe & Ambush" Meets the Power of Behind the Scenes Persuasion.**
6. **Better Index IR and Not Taking the Passives (or Other Investors) for Granted.**
7. **Quarterly Earnings Rituals.**
8. **Embracing the New Paradigm and Long-Termism.**
9. **Convergence on ESG and Sustainability.**
10. **Dealing with the Proxy Advisory Firms.**
11. **Board Culture, Corporate Culture and Board Quality.**
12. **Capital Allocation.**
13. **Directors as Investor Relation Officers.**
14. **The General Counsel as Investor Relations Officer.**
15. **The Nature of Corporate Governance.**

---

1. **The CEO, the Board and the Strategy.**

- The relationship of the CEO with fellow directors will remain the most important, overriding corporate relationship a CEO has.

- Strengthening that relationship, addressing disconnects openly and directly, and ensuring internal clarity and alignment between the board and management should be prioritized before an activist, takeover threat or crisis emerges.

- Boards of directors will become more actively involved with management in developing, adjusting and communicating the company's long-term strategy and operational objectives and anticipating threats to progress.

2. **Activism Preparedness Grows Up**.

- Instead of a check-the-box housekeeping exercise, companies will pursue real readiness for activist attacks.

- Activism preparedness will be integrated into crisis preparedness, strategic planning and board governance.

- This will include periodic updates for the board by expert advisors working with management; non-generic break glass plans; a philosophy of continuous improvement and rejecting complacency; training, simulations and education informed by live activism experiences; expert review of bylaws and governance guidelines; and cultivating third-party advocates early.

- Most importantly, deep self-reflection and self-help will identify opportunities for strengthening the company and increasing sustainable value for all stakeholders, mitigating potential vulnerabilities, getting ahead of investor concerns and ensuring that the company's strategy and governance is well-articulated, updated and understood.

- The CEO and other directors will be prepared to deal with direct takeover and activist approaches and handle requests by institutional investors and activists to meet directly with management and independent directors.

3. **Companies Standing Up, Playing Offense and Showing Conviction without Capitulation**.

- Well-advised companies will take a less reactive posture to activist attacks, find opportunities to control the narrative, strengthen their positioning and leverage with key investors and stakeholders and understand investor views beyond the activist.

- Directors and management will maintain their composure and credibility in the face of an activist assault and not get distracted or demoralized.

- Companies will proactively take action and accelerate previously planned initiatives with wide support to demonstrate responsiveness to investor concerns without acceding to an activists' more destructive or short-sighted demands.

- If a legitimate problem is identified, consider whether the company has a different (better) approach than the one proposed by the activist, and if the activist's idea is a good one, co-opt it.

- Companies with iconic brands and a track record of established trust will protect – and appropriately leverage – their brands in an activist situation.

- Negotiating and engaging with an activist from a position of strength rather than fear or weakness will become more common.

4. **Activists Standing Down.**

- Through deft handling and prudent advice, more activist situations will be defused and never become public battles, including where the activist concludes they would be better served by moving on to another target.

- Companies who move quickly to pursue the right initiatives, maintain alignment within the boardroom and engage in the right way with key shareholders and constituencies will achieve beneficial outcomes, gain the confidence of investors beyond the activist and, where dealmaking with an activist is needed, find common ground or obtain favorable settlement terms.

5. **"Shock, Awe & Ambush" Meets the Power of Behind the Scenes Persuasion.**

- Until activism evolves, boards and management teams will continue to grapple with activists who mislead, grandstand, goad, work the media, threaten and bully to get their way.

- But major investors will increasingly reject such irresponsible engagement and more interesting flavors of activism will emerge, led by self-confident and secure funds who value thoughtful, private discussions as to how best to create medium-to-long-term value, respect that boards and management teams may have superior information and expertise and valid reasons for disagreeing with an activist's solutions, and pursue collaborative, merchant banking approaches intended to assist a company in improving operations and strategies for long-term success without worrying about who gets the credit.

- In some situations, working with the right kind of activist and showing backbone against misaligned activist funds and investors will deliver superior results.

6. **Better Index IR and Not Taking the Passives (or Other Investors) for Granted.**

- BlackRock, State Street and Vanguard will continue to bring their own distinctive brands of stewardship, engagement and patient pressure to bear in the capital markets and at their portfolio companies.

- Companies will increasingly recognize that a classical "governance roadshow" promoting a check-the-box approach to governance without a two-way dialogue is a missed opportunity to demonstrate to these funds that the company's strategic choices, board and management priorities and substantive approach to governance deserve support from these investors.

- More sophisticated and nuanced approaches for gaining and maintaining the confidence of all investors will emerge.

- Engagement for engagement's sake will fall out of favor, and targeted, thoughtful and creative approaches will carry the day.

7. **Quarterly Earnings Rituals**.

- While quarterly earnings rituals will remain, for now, a fact of life in the U.S., companies and investors will explore alternatives for replacing quarterly rhythms with broader, multi-year frameworks for value creation and publishing new metrics over timeframes that align with business, end market and operational realities. Giving quarterly guidance will fall out of favor and be increasingly criticized.

- In the U.K. and other jurisdictions that permit flexibility, more companies will move towards non-quarterly cadences for reporting and issuing guidance and seek to attract more long-term oriented investor bases by publishing long-term metrics.

- In all markets, companies will increasingly discuss near-term results in the context of long-term strategy and objectives, more management time will be spent discussing progress towards important operational and financial goals that will take time to achieve and sell-side analysts will have to adapt to a more long-term oriented landscape or find their services to be in less demand.

8. **Embracing the New Paradigm and Long-Termism.**

- The value chain for alignment towards the long-term across public companies, asset managers, asset owners and ultimate beneficiaries (long-term savers and retirees) – each with their own time horizons, goals and incentives – is now recognized as broken.

- Organizations and initiatives like *Focusing Capital on the Long Term*, *the Coalition for Inclusive Capitalism, the World Economic Forum's New Paradigm and Roadmap for an Implicit Corporate Governance Partnership to Achieve Sustainable Long-Term Investment and Growth, the Conference Board, the Strategic Investor Initiative, the Aspen Institute's Business & Society Program and Long-Term Strategy Group* and others will increasingly collaborate and perhaps consolidate their efforts to ensure lasting change in the market ecosystem occurs.

- Additional academic and empirical evidence will be published showing the harms to GDP, national productivity and competitiveness, innovation, investor returns, wages and employment from the short-termism in our public markets.

- Absent evidence that private sector solutions are gaining traction, legislation to promote long-term investment and regulation to mandate long-term oriented stewardship will be pursued worldwide.

9. **Convergence on ESG and Sustainability.**

- Companies will increasingly own business-relevant sustainability concerns, integrate relevant corporate social responsibility issues into decision-making and enhance disclosures in appropriate ways, while resisting one-size-fits-all approaches delinked from long-term business imperatives.

- ESG-ratings services will come under heightened pressure to improve their quality, achieve consistency with peer services, eliminate errors and proactively make corrections or retract reports and ratings.

- Activist hedge funds will continue to experiment with ESG-themed or socially responsible flavored campaigns to attract additional assets under management, drive a wedge between companies and certain classes of ESG-aligned investors and try to counter their "bad rap" as short-term financial activists who privilege financial engineering and worship the immediate stock price.

- Mainstream investors will increasingly try to apply and integrate ESG-focused screens and processes into investment models.

10. **Dealing with the Proxy Advisory Firms.**

- While proxy advisory firms will increasingly become disintermediated, including through efforts like the U.S. Investor Stewardship Group (ISG) and increased investments by active managers and passive investors in their own governance teams and policies, proxy advisors will retain the power to hijack engagement agendas and drive media narratives.

- More scrutiny will be brought to bear when advisory firms overreach, where special interests drive a new proxy advisory firm policy and if investors reflexively follow their recommendations.

- Especially in contested situations, winning the support of the major proxy advisory firms is valuable, but well-advised companies will succeed in convincing investors to deviate from negative recommendations and in special cases persuading advisory firms to reverse recommendations.

- Negative recommendations will be managed effectively without letting the proxy firm dictate what makes sense for the company.

11. **Board Culture, Corporate Culture and Board Quality.**

- Leaders who promote a board culture of constructive support and engaged challenge and who foster a healthy and inclusive corporate culture will outperform.

- Vibrant board and corporate cultures are valuable assets, sources of competitive advantage and vital to the creation and protection of long-term value.

- Board strength, composition and practices will be heavily scrutinized, including as to director expertise, average tenure, diversity, independence, character, and integrity.

- Nuanced evaluations of the ongoing needs of the company, the expertise, experience and contributions of existing directors, and opportunities to strengthen the current composition will be integrated into proactive board development plans designed to enable the board's composition and practices to evolve over time.

- Failure to evolve the board and its practices in a measured way will expose companies to opportunistic activism and takeover bids.

- Boards and management teams who know how to navigate stress, pressure, transition and crisis will thrive.

12. **Capital Allocation.**

- Investors will have more heated debates among themselves and with companies about preferred capital allocation priorities, both at individual portfolio companies and at an industry level.

- Companies will be more willing to reinvest in the business for growth, pursue smart and transformative M&A that fits within a longer-term plan to create value and make the case for investments that will take time to bear fruit by explaining their importance, timing and progress.

- Prudently returning capital will remain a pillar of many value creation strategies but in a more balanced way and with more public discussion of tradeoffs between dividends versus share repurchases and alternative uses.

- Investors may not agree with choices made by companies and will disagree with each other.

13. **Directors as Investor Relation Officers.**

- While management will remain the primary spokesperson for the company, companies will better prepare for director-level interactions with major shareholders and become more sophisticated in knowing when and how to involve directors –

proactively or upon appropriate request – without encroaching upon management effectiveness.

- Directors will be deployed carefully but more frequently to help foster long-term relationships with key shareholders.

- However, directors will need to be vigilant to ensure the company speaks with one voice and guard against attempts by investors to pursue inappropriate one-off engagements and foster mixed messages.

14. **The General Counsel as Investor Relations Officer.**

- The general counsel (or its designee, such as the corporate secretary or other members of the legal staff) will play an increasingly central role in investor relations functions involving directors, senior management and the governance and proxy voting teams at actively managed and passive funds alike.

- Board and management teams will look to the general counsel to advise on shareholder requests for meetings to discuss governance, the business portfolio, capital allocation and operating strategy, and the board's practices and priorities and to evaluate whether given demands of corporate governance activists will improve governance or be counterproductive.

15. **The Nature of Corporate Governance.**

- Questions about the basic purpose of corporations, how to define and measure corporate success, the weight given to stock prices as reflecting intrinsic value, and how to balance a wider range of stakeholder interests (including employees, customers, communities, and the economy and society as a whole) beyond the investor will become less esoteric and instead become central issues for concern and focus within corporate boardrooms and among policymakers and investors.

- Measuring corporate governance by how many rights are afforded to a single class of stakeholder – the institutional investor – will be seen as misguided.

- Corporate governance will increasingly be viewed as a framework for aligning boards, management teams, investors and stakeholders towards long-term value creation in ways that are more nuanced and less amenable to benchmarking and quantification.

Sabastian V. Niles