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PERSPECTIVE

Preparing for activism after it arrives is too late

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No public company, however large, is immune from the possibility that an activist investor will disrupt the company's long-term strategy by running a proxy contest or other pressure campaign to unseat the board, change corporate governance policies, or force the company to sell itself in whole or in part. Addressing activism after it arrives is too late, and for good reason: you have had years to run the company as you wish and hasty attempts at change in reaction to an activist campaign will seem like confessions of error that you have not been running the business in the most effective way.

The best activism defense occurs before the activist has shown up at the door. What does it involve? Here's some concrete advice.

First, the key defense against potential activism is a sound strategy by the management and board to create sustainable profits for long-term investors. Subject that strategy to vigorous internal oversight and refinement, try to look around corners, anticipate key risks, and implement a sensible plan to make money by selling valuable products or services that make their customers better off. A sound strategy can be explained in terms that investors understand, because it involves a reasoned way the company can take advantage of its unique attributes to be a market leader.

Second, regularly and candidly explain that strategy to the company's key stakeholders, and most important for activism defense, to the company's long-term investors. Most companies have a relatively stable base of large institutional investors – comprised of index funds and large actively managed funds that concentrate in certain industries. Communicate with them in a serious, authentic way on an ongoing, at least yearly basis. Listen to investors' constructive input and factor it in as you consider the company's strategy and demonstrate to them management's expertise and commitment to delivering sound returns. You want to gain credibility and trust all the time, not try to conjure it out of nothing when the stuff hits the fan. Introducing yourself to your long-term stockholders when you need their vote to defeat an activist is a bad way to make a first impression. Management and the lead independent director should regularly update the board on the results of their engagements with shareholders and other stakeholders.

Finally, continually think hard about management and board strength and succession. As a board, make sure that management is at the top of their game, has market credibility, and is not past its sell-by date. Build a strong internal bench for succession at all times – otherwise activists will be more than happy to suggest one. Think hard about yourself as a board: the board itself must be comprised of accomplished, diverse members with industry-relevant expertise and have a committee structure that makes sense in terms of the company's industry space. Be thoughtful in choosing the categories highlighted by the skills matrix in your proxy, because those choices tell your shareholders what the company values. Not every industry is the same, and when a proxy fight or other activism campaign arises, the company should be able to explain why its management team and board have been built to ensure that the company can best succeed in the markets in which it operates. Having a pharma, food, energy, or tech company that does not have directors with expertise in those sectors, or a risk management structure that doesn't match what makes sense in that space, are weak spots that activists can successfully target. When it comes to activism defense, the management and board are only as strong as their weakest members and structures. As a board and management team, be candid with each other and self-aware; understand that unless you address points of weakness yourselves by appropriate turnover when that is useful to effective decision-making and execution, you will not just leave yourselves vulnerable in an activist campaign, you will not be doing your best by the company.

These three points are not independent from one another. They are parts of an interactive process of sound governance. You can't develop and oversee a sound business strategy without strong management and board members and processes that encourage good thinking. You can't have that good thinking without constructive feedback from your long-term investors on a regular basis, and you can't get that input without engaging with them authentically on an ongoing basis, not just when "you need them." Doing these three key things is not always easy. But these things are essential, not tangential, to running a sustainably profitable business.

Even good companies have difficult times or are targeted by activists unfairly. The good news is that when a company has built the credibility that comes from doing things the right way, experience shows that when activism comes, the company best positions itself to prevail if the campaign results in a fight at the ballot box, or to resolve the situation short of that high-stakes drama in a sensible, cost-effective way that preserves the company's long-term strategy for the best interests of all its stakeholders.

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