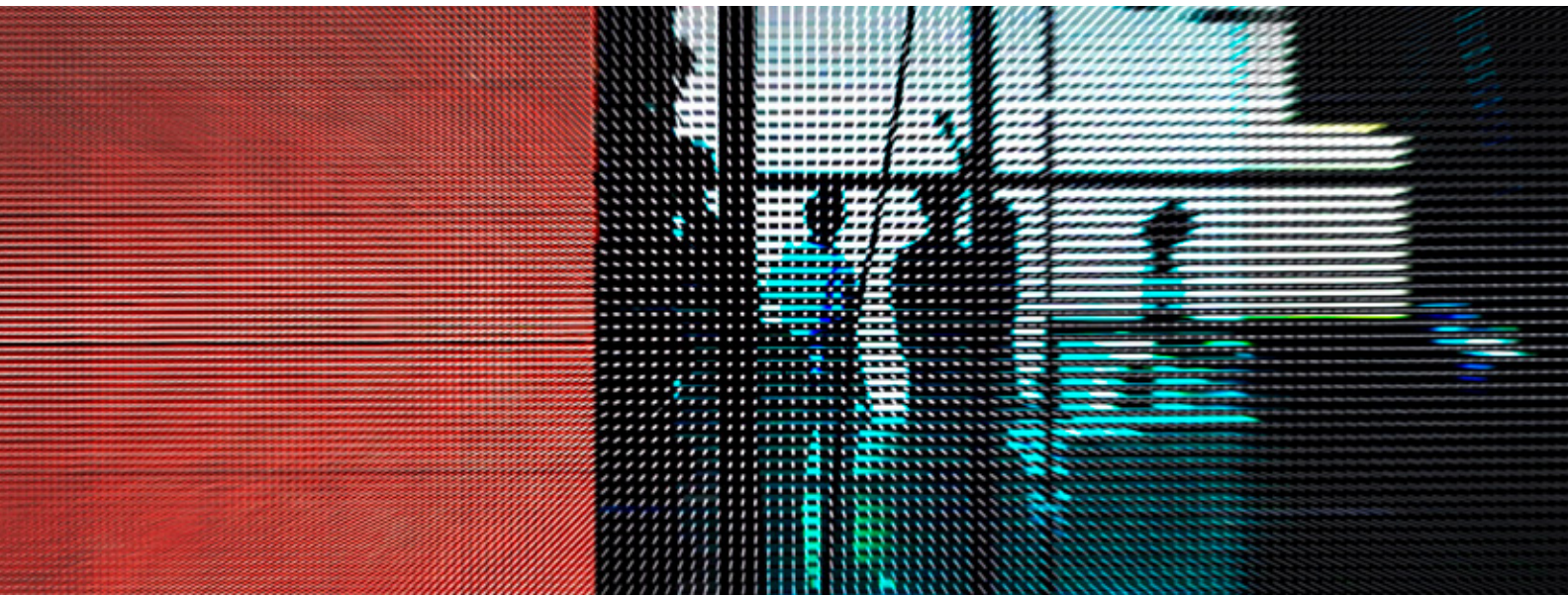




Lessons from Directors: How Boards Can Prepare for Activist Investors

Spencer Stuart's latest [director pulse survey](#), about how boards and directors are responding to activist investor campaigns, included the following open question: *In your opinion, what is the best way for a board to prepare for an activist investor situation?*

The more than 175 responses offered a unique window into directors' own experiences during activist situations, and their advice on how to prepare for them. "Knowing how to handle an activist is now a core board skill," as one respondent said.

In this article, we share some of those first-hand experiences from directors about their hard-won lessons learned, their insightful tips, and their informed perspectives on how to prepare for activist incursions and what to do after an activist campaign begins.

1. “Think like an activist”

Every director has heard the advice to view your company through the eyes of an activist, and it still holds true. Nothing is more important when it comes to activism defense than taking the boardroom blinders off, objectively assessing company and board vulnerabilities, and proactively taking action to address issues.

“Think like an activist,” one director wrote. “Understand where they are likely to attack (capital allocation, poor profitability, the sum of the parts is greater than the whole, misaligned management incentives, etc.) and proactively address these areas.”

Many directors said it was critical to be able to identify early the issues activists may push you on, from board governance to strategic decisions, and then determine a course of action, whether that’s acting on the issue or explaining why you did not.

At the same time, it’s important to articulate what’s going well with your company, and why it would in fact be a great place to invest. If your company has a good story to tell, don’t be afraid to tell it.

“Self-assess constantly,” said another director. “Scrutinize board composition, performance and strategic alignment before outsiders do.”



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Questions for boards

- » If you were an activist investor, what vulnerabilities would you target in this company and its boardroom?
- » How does your performance compare to your peers? Can you defend against critiques about inefficiency or poor profitability?
- » How are you proactively addressing issues that could otherwise become activist talking points?

2. Review your board composition

It can be difficult for boards to look in the mirror and identify weaknesses in their own composition. But this self-reflection is crucial, particularly in today's environment of the universal proxy card.

“A board needs to be honest with itself about whether it as a whole is effective in providing oversight,” one respondent said. “Long-tenured board members tend to act more like insiders and dismiss activism threats, and they also tend to defend management and company direction to a fault.”

Activists will scrutinize board composition to identify boardroom weaknesses — such as overall composition poorly aligned with company strategies, limited director turnover, long-retired directors and lengthy director tenures — to identify directors to be replaced. Proactively addressing these shortcomings is essential.

“Hold the board to the same standards that it holds management to, in terms of performance and capability,” a different director wrote. “Avoid situations where you keep board members who would no longer be considered strong candidates at this stage.”



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Questions for boards

- » Does your board have the right mix of skills and perspectives to effectively oversee and challenge management?
- » Do you have long-tenured directors whose independence or objectivity could be questioned by activists?
- » How are you currently evaluating board performance, both individually and collectively, and what processes do you have to ensure effective board refreshment?

3. Maintain best-in-class investor communications

It is critical that boards' public communications offer insights and context that enable investors to understand company strategy and performance. Company performance is generally the first area that activists screen, so the boards of organizations facing performance challenges should be particularly vigilant in their shareholder communications.

"It helps a great deal if the company's communication strategy provides color and transparency on publicly available information," one respondent said. "Asymmetry of information often leads activists (not to mention also 'regular' investors) to draw their own conclusions that may not necessarily be supported by the facts."

Proactively engaging with key investors, including portfolio managers and stewardship team members, can also pay dividends in the event an activist reaches out. "Just say no" is rarely a winning strategy; instead, it pays off to thoughtfully listen to activists and carefully evaluate their views.

"Regular, authentic communication builds trust and reduces surprise," one respondent told us.



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Questions for boards

- » What is your engagement strategy, beyond required communications, with your key investors? What is your strategy for engaging with activist investors when they appear?
- » Are you having candid and constructive conversations about your boardroom strategy, risks and performance?
- » Is the board and management team fully aligned on the strategy and performance of the company?

4. Use scenario planning to prepare for activists

Addressing risk is increasingly an issue managed by the full board, rather than being delegated to the audit committee. When it comes to activists, the best-prepared boards periodically engage in table-top exercises to evaluate potential activist scenarios and develop playbooks for rapid response. They run mock activist scenarios and have ongoing discussions about what responses would be appropriate in which situations.

“It’s important to practice response scenarios,” said one director. “Have a plan and a playbook. When your board is merely reactive, you lose control of the narrative.”

Going back to the “think like an activist” point, boards can use scenario planning to understand how activists may respond to different situations.

“Do the scenario planning on all the things that an activist investor would most likely focus on,” one respondent said, “and ensure that the company has evaluated all of those options itself and has solid reasons as to whether or not to pursue them.”



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Questions for boards

- » Are you conducting effective scenario planning activities and using the best tools and advisers for these exercises?
- » How would you respond if an activist called tomorrow with a critique of our strategy?
- » Have you run realistic simulations of potential activist scenarios, and do you have a clear playbook for those scenarios?

5. Engage outside advisers

External advisers can offer valuable “outside-in” perspectives on company and board vulnerabilities and provide deep knowledge of activist strategies. Working with advisers can not only help boards objectively assess vulnerabilities, but also proactively identify a go-to team of people to engage in the event of activist interest.

“External review by industry experts can ensure that your strategy and approach for the company is considering all potential means of creating value,” a respondent said.

One respondent, however, warned against overdoing it with the advisers. “Don’t over-rotate with too many advisers,” this director said. “Too many cooks can water down the effectiveness of the approach and the speed of decision-making.”



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Questions for boards

- » What gaps are there where an external adviser can provide valuable information and advice?
- » Do you have the right balance between internal expertise and external counsel, without overcomplicating decision-making?
- » How do you ensure we’re getting independent, objective advice rather than just validation?

Conclusion

The question isn’t if your board will face scrutiny from activist investors, but when. Boards cannot afford to wait until an activist knocks on the door. Instead, they should be proactive in honestly assessing their company’s performance, challenging their own composition, communicating clearly and openly with each other, with management and with investors, and having a playbook for the moment when activist investors start asking questions. At the end of the day, by acting boldly and courageously, boards can execute on their new reality and improve outcomes for their company.

Preparation isn’t just about preparing your company; it’s about defining its future.





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