

Shareholder activism and the board

Although shareholder activism is not new, it is evolving in ways that present new challenges for boards. Companies face broader pressure, from a broader group of investors, to change their practices. While the issues that gave rise to activist campaigns in the past have not gone away, a global pandemic, urgency on climate-related issues, and an enhanced focus on people and talent have expanded the avenues that shareholders are using to push managers and boards.

On September 22, Lead Director Network members were joined by Jim Rossman, co-head of Capital Markets Advisory at Lazard, to discuss current trends in shareholder activism and how boards can effectively prepare for and respond to an activist campaign.

This *Summary of Themes* provides a brief overview of the meeting. *For a full list of meeting participants, please see page 6.*

The stigma of activism is fading away

In a variety of ways, shareholder activism is becoming more mainstream. Mr. Rossman said, *“Over the last two years, activism has moved closer to the mainstream as an acceptable behavior and posture for shareholders to take toward companies.”* Increased acceptance has led more money to flow to activism strategies and opened doors for investors who pursue these strategies. Mr. Rossman explained that as the stigma has faded, activists now have access to advisers, like banks, law firms, and PR firms, that historically shunned working with them. As a result, Mr. Rossman said, *“activists are more sophisticated and more experienced today. They have better research and are more prepared than they’ve been before.”*

At the same time, trends among other investors have paved the way for activism. This starts with concentration of ownership in large, public companies. Mr. Rossman noted, *“BlackRock, Vanguard, and State Street now own more than 20% of nearly every major public company in the country. You’re going to see the further concentration of ownership. It will become just a heck of a lot easier for activists to gain influence among your shareholder group.”*

He added that activists have also become better campaigners: *“It’s almost like community organizing. If they start with the passive investors and the pension funds, they can quickly demonstrate support and pressure management and boards to make decisions.”*

Environmental, social, and governance (ESG) activism is only just beginning to take form

As environmental and social issues take center stage, campaigns organized around ESG themes are a growing part of shareholder activism. Engine No. 1's successful proxy contest at Exxon Mobil, which included a deep criticism of Exxon's climate transition plans, radically reshaped the landscape. One lead director stressed that boards must convince their investors that they are on track to achieve both financial performance and sustainability: *"Exxon was a case where the board lost the trust of its investors. You have to actually do the work and have evidence; just being a great collection of individuals is not enough."* The combination of an ESG issue with financial underperformance made this campaign uniquely potent. *"I think that it was the notion of economic performance clothed under an ESG framework that was ultimately the root cause of this issue,"* a lead director said, suggesting that activists had seized upon ESG weaknesses to rally other investors behind their campaign.

Mr. Rossman suggested that pure ESG activism is likely to emerge, as *"ESG themes are affecting decision-making and capital allocation."* However, LDN members were skeptical about whether investors would support environmental or social campaigns at high-performing companies. One said, *"ESG is important in and of itself, but an activist also needs to get at an underlying financial issue. The end game for them needs to include profitable returns. That's how they get paid and that's how they market themselves to investors."*

Members also acknowledged that investors' views about companies are shaped by public perception. Mr. Rossman said, *"In our politicized world, public perception, fair or unfair, could become the investor perception of our company and could move very quickly because of social media."* As a result, part of the activism-defense playbook includes a deeper understanding about what various stakeholders think of the company. Activists are likely to seize on cases in which a company is viewed as being on the wrong side of an environmental or social issue. One member said, *"This is a new attack vector for the activist."*

Investor relations teams are under pressure to up their game

Many companies are reassessing their approach to investor relations (IR) to ensure they are focused on the right issues and meeting with the right people. One lead director said bluntly, *"IR is not equipped for a high-level crisis or attack."* Another said, *"I start with the expectation that an unanticipated activist campaign is a failure of management. The board has to make sure we have a highly effective IR function."*

Making sure that the IR team is elevated within the company and that IR is seen as a career role is crucial. A member said, *"The IR function is critical, and the more senior IR person, the greater the reception is because he or she will have credibility."* Members said that their IR professional needs to strike the right balance between spending time outside the company with investors and spending time with management to understand the issues. They added

that, in all cases, their IR team must be equipped to brief investors on the full suite of relevant issues, not just financial performance. Mr. Rossman also emphasized the importance of IR engaging with a broader group: *“If 25% of the company is owned by index funds, it is critical that IR build relationships with the stewardship teams at those funds just like they build relationships with other investors.”*

Lead directors are taking steps to get more involved in the IR process and reviewing materials in a more detailed way. One said, *“With the increased emphasis on ESG, the board is actually reviewing the investor decks that talk about our commitment to not just create financial economic value, but value for all of the ESG stakeholders as well.”* They also expect their IR functions to provide the board with a robust picture of their shareholder base and the questions that investors are asking. In some cases, this may lead to more direct engagement between the board and investors.

Successful activism defense depends heavily on preparation

Lead directors said that boards must be constantly aware of and prepared for the threat of shareholder activism. One step that many boards are taking is to bring in an outside expert to brief them both on trends in activism and on what might make their companies vulnerable to criticism. Members find this approach helpful but cautioned against trying to fix everything. One said, *“You can get a letter and there can be a list of 10 things they think you should do, some of which the board may say, ‘No, that doesn't make sense strategically.’ I do think it's important for us to keep that in mind; they do a lot of research, and they spend a lot of money, but they aren't always right.”*

Mr. Rossman emphasized that often activist disputes are more about perception than reality: *“You need to know how they are going to portray you. Ask your advisers to give you the false narrative an activist might advance, so you can discuss it with management and not be caught off guard.”* Mr. Rossman also encouraged members to prepare activism-defense strategies during these sessions to spark ongoing dialogue among the board, management, and advisers: *“When you do it repeatedly, you can track the issues and how the company responds.”*

Board trends and commitments related to ESG

Boards are facing increasing pressure to make concrete, public commitments on ESG matters. LDN members discussed their companies' decisions to set specific targets on high-profile issues and whether to make those targets public. One said, *“You have to be a fast follower and a fast adopter. There are so many standards around ESG, and you need to be getting out ahead of that or you could be embarrassed later.”* Another emphasized the risk involved in making a public commitment, asking, *“How much are you willing to put out in the public domain?”*

Members expressed discomfort around long-term commitments and how those should be realized. One member noted, *“It’s easy to set a goal, but where are the teeth in it?”* The public will hold companies to their commitments, so they need to establish benchmarks to actualize those commitments. While it may have been enough in the past for companies to declare certain goals around ESG, now they are required to be more concrete. One member explained, *“You can put the goal out there and think that gets the heat off of us and protects the company, but I think we’re living in an environment where the next wave of activism will come around and they will say, ‘Let’s see the specifics.’”*

About this document

Summary of Themes reflects the network's use of a modified version of the Chatham House Rule whereby names of members and their company affiliations are a matter of public record, but comments made before and during meetings are not attributed to individuals or corporations. Guests, however, have given permission for their remarks to be attributed. Comments by guests and network members are shown in italics.

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Appendix: Meeting participants

The following Lead Director Network members participated in the meeting:

- Alan Bennett, Lead Director, TJX and Fluor
- Marcela Donadio, Lead Director, Marathon Oil
- Paulett Eberhart, Former Lead Director, Anadarko
- Curt Espeland, Lead Director, Lincoln Electric
- Ann Hackett, Lead Director, Capital One
- Glenn Hubbard, Non-Executive Chair, MetLife
- Lou Lavigne, Lead Director, Zynga and Alector
- Steve Leer, Lead Director, Norfolk Southern
- Suzanne Nimocks, Lead Director, Owens Corning
- Pat Russo, Non-Executive Chair, Hewlett Packard Enterprise
- Ted Samuels, Lead Director, Bristol-Meyers Squibb