M&A, Activism, and the Shareholder Landscape

On June 13, 2023, the Lead Director Network (LDN) met in New York City to discuss the current mergers-and-acquisitions (M&A) environment, as well as trends in investor activism and broader shareholder dynamics. Members were joined by Evercore’s Bill Anderson, Senior Managing Director and Head of Strategic M&A, Defense and Shareholder Advisory, and Zach Oleksiuk, Managing Director and Head of Shareholder Engagement, for this discussion.

The meeting also included off-the-record discussions on implications for directors related to the SEC’s activities on board oversight of risk, cyber, and environmental, social, and governance (ESG) with Elad Roisman, Partner at Cravath, Swaine & Moore LLP and former Commissioner and Acting Chair of the U.S. Securities and Exchange Commission (see side bar beginning page 2-3), and a dinner discussion about national security issues with Jeh Johnson, Partner at Paul, Weiss and former U.S. Secretary of Homeland Security.

This document uses the term “lead director” to refer interchangeably to the titles lead director, presiding director, and non-executive chair, unless otherwise stated. For a full list of meeting participants, please see page 6.

Adding to macroeconomic challenges, increased pressure from shareholders creates a difficult environment for companies and boards

Economic conditions – including higher interest rates, an unfavorable regulatory environment, and a scarcity of financing options – have created a difficult mergers-and-acquisitions market in the first half of this year. And although many economists are predicting a recession in the second half of the year, a combination of attractive valuations and management teams becoming accustomed to the current economic environment may lead to an uptick in M&A activity.
Adding to the broader difficulties in the deal market “the number of shareholder challenges is enormous,” Mr. Anderson said. He noted that shareholder activism has rebounded to pre-pandemic levels and that “there is real pressure on companies.”

Lead directors and guests discussed the current activism and shareholder landscape including good practices for boards and management in preparing for and defending against activists. Key themes included:

- **Boards and management should monitor potential indicators for activist activity.** Activists frequently turn to certain types of information in crafting a case against a company, many of which boards and management can proactively assess. The Evercore guests highlighted several:
  
  - **Total shareholder returns (TSR), operating performance and capital allocation,** especially one, three and five year TSR relative to peers and the index.
  - **Shareholder sentiment.** Understand key supporters, emerging issues, and potential hostile accumulations.
  - **Periods of management change** Activists are coming for new CEOs in the first or second year of their tenure in “staggering” numbers.
  - **Sell-side research.** Sell-side reports can provide fodder to activists in building their case against companies.
  - **Say-on-pay and other annual meeting votes.** Some activists may claim that votes falling below market average are a signal of investor discontent – e.g. the average say-on-pay-vote passes with approximately 90% support.
  - **Valuation and “sum-of-the-parts” arguments.** Boards and companies should have a response at the ready in the event of an unsolicited low-premium bid or a public call for a break-up or other strategic change.
  - **ESG.** While there has been downward trend in ESG activism, investors are still supporting ESG shareholder proposals that are perceived as leading to appropriate improvements. Typically, this means less prescriptive proposals and those that zoom in on a specific issue such as climate or DEI.
• **The qualifications of individual board members will increasingly be in the spotlight...** Adding to the sustained focus of activists on board composition, the new Universal Proxy rule – which requires companies to include activist director nominees on their proxy card – is expected to add scrutiny on directors’ qualifications. One lead director noted that “activists are coming for individual directors, and it can be personal...You need to be able to defend each director.” Mr. Anderson agreed and flagged three areas currently under the microscope for directors:

  o **Experience**, particularly relevant industry or sector experience. While this may seem obvious, Mr. Oleksiuk added that many large companies still lack board members with directly relevant industry experience.

  o **Tenure** of each board member. According to Evercore’s research, 72% of activist campaigns since 2021 have occurred at companies where three or more directors had tenures over 10 years; and

  o **Diversity** of both individual directors and the composition of the board overall.

• **But don’t give board seats away unnecessarily.** A member noted that, following Universal Proxy adoption, “It seems that companies are more inclined to settle and bring on an activist candidate.” Mr. Anderson agreed that that was a trend but disagreed with the strategy: “Don’t give seats away,” he said. “Why would you give up seats before getting input from other shareholders? Do your due diligence and defend the board seats if it’s reasonable.”

He highlighted three types of board members that he thinks boards should have: 1) a (former) CEO who focuses on value creation; 2) a “tough” CFO...

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**REGULATORY FOCUS ON BOARD EXPERTISE**

In addition to shareholder scrutiny of board composition, the U.S. Securities and Exchange Commission (SEC) has ramped up its focus on boards. Notably for this network, the SEC has sent comment letters to companies seeking additional information about the board’s and lead director’s roles in risk oversight.

The letters, in general, ask companies to expand upon discussions of leadership structure and risk oversight process in future proxy statement disclosures.

Some letters specifically ask the company to “expand upon the role that your Lead Director plays in the leadership of the board” including related to:

  o “Represent[ing] the board in communications with shareholders and other stakeholders;”

  o “Overrid[ing] your CEO on any risk matters;” and

  o “Provid[ing] input on the design of the board itself.”

Members also discussed requirements in pending SEC rule proposals that would require new disclosures around directors’ subject matter expertise.

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who can ably defend against attacks on capital allocation or costs; and 3) a former institutional investor – such individuals often know and understand the investor ecosystem and its players and have insight into what investors are looking for.

- **Utilize and support a strong investor relations function...** Members stressed the importance of proactive shareholder engagement with investors and a strong investor relations (IR) function – not just for combatting activists – but for responding to a variety of issues. One lead director said: “Because we had best in class shareholder outreach, when we had a massive, public crisis, we had access to our investors and the opportunity to tell our story because they knew us.”

But another described the tension that exists since IR reports to the CEO noting, “In some cases, the board may not get the unfiltered feedback from IR that it needs. Our shareholders were outraged about CEO pay, but IR wasn’t sharing this with the board.” That lead director now has IR meet with the board in an executive session. While executive sessions with IR seemed to be an outlier practice based on a show of hands from other members, several lead directors did highlight the value of third party surveys that track how internal and external stakeholders view the company, such as Rivel, as a good way for the board to receive unfiltered feedback.

- **...But also look for opportunities to engage directly with investors, particularly index funds.** Passive ownership has doubled in the last seven years, with the average company in the S&P 500 having over 20% of its stock owned by passive vehicles such as index funds in 2022. Further, Mr. Anderson noted, while actively managed funds and proxy advisors are increasingly siding with activists, index funds are still broadly supportive of management. So effective, peacetime engagement with all investors – but especially passive investors – is more critical than ever.

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For example, the SEC’s proposed rule on cybersecurity risk management would require disclosure about “the board of directors’ cybersecurity expertise, if any...” And the agency’s proposed rule on climate-related disclosures similarly would require disclosure related to “whether any member of a registrant’s board of directors has expertise in climate-related risks, with disclosure required in sufficient detail to fully describe the nature of the expertise.”

Integrating “non-generalists” onto the board concerned members, with one wondering if they would “have enough relevant experience to become functioning board members and contribute on governance and management issues more broadly?”
But given the number of companies that index funds own and the small teams that often handle engagements, being strategic about identifying when and with whom to engage is important. Suggestions included:

- **Find ways to build relationships.** A member stressed, “There is real benefit in having proactive engagement, once or twice a year, before you need it. It helps then if there is an issue and you need to make your case. You’ve already built a relationship over time.” Mr. Oleksiuk concurred and suggested sending investors a quarterly update around earnings or a brief email on a topic of relevance to index fund priorities; for example, if a new board member is named or a new sustainability report is published. Creating this file will not only familiarize a passive investor with what is happening at the company, he noted, it will also help them know who to reach out to if they have a question or concern.

- **Make a phone call if needed.** One lead director emphasized the value of picking up the (proverbial) phone. “I was over-boarded according to one fund’s voting policy, so I got on a video call with them and explained why I – and the company and rest of the board – felt confident that I could perform my responsibilities. It was effective and they actually changed their vote.”

- **Humanize the board.** Mr. Anderson suggested inviting index funds to occasionally present to the board on their views of the company as well as their proxy voting policies. “Shareholders appreciate humanizing the board,” he said. “They often just see names and past jobs in the proxy statement, so it helps to add context to who you are. If they can’t come in to present to the board, consider sending the lead director or other appropriate board member to meetings with index funds.”

- **Engage in the “off season.”** While investors are now engaging throughout the year, it’s best to avoid unnecessary communications or requests around the annual meeting season – when they are at their busiest – Mr. Oleksiuk said.
Appendix 1: Meeting participants

The following members participated in all or part of the meeting:

- **Alan Bennett**
  Lead Director, Fluor and TJX

- **Marcela Donadio**
  Lead Director, Marathon Oil

- **Curt Espeland**
  Lead Director, Lincoln Electric

- **Mark Feidler**
  Non-Executive Chair, Equifax

- **Ann Hackett**
  Lead Director, Capital One Financial

- **Gail Harris**
  Lead Director, Evercore

- **Frederick A. (Fritz) Henderson**
  Lead Director, Marriott International, Arconic, and Adient

- **David Herzog**
  Lead Director, DXC Technology Company

- **Mel Lagomasino**
  Lead Director, Coca-Cola

- **Suzanne Paquin Nimocks**
  Lead Director, Owens Corning

- **Chuck Noski**
  Lead Director, Booking Holdings

- **Joe Reece**
  Lead Director, NCR Corp.

- **Timothy Yates**
  Lead Director, CommScope

Evercore was represented in all or part of the meeting by the following:

- **Bill Anderson**
  Senior Managing Director and Global Head of Strategic, Defense and Shareholder Advisory, Evercore

- **Zach Oleksiuk**
  Managing Director and Head of Shareholder Engagement, Evercore

- **Heather Sahrbeck**
  Managing Director, Evercore
About this document

ViewPoints 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 are not attributed to individuals or corporations. Italicized quotations reflect comments made in connection with the meeting by network members and other meeting participants.

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Endnotes

1 Passive ownership of S&P 500 doubles in seven years, Jamie Gordon, ETF Stream (June 8, 2022)