A Call for Greater Board Leadership Amid Shareholder Activism

By Reatha Clark King

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Monumental shifts in our business environment are causing directors to re-examine their roles, responsibilities, and practices in search of ways to be more effective as corporate fiduciaries. In addition to ongoing oversight of issues specific to CEO succession, executive compensation, and risk oversight, directors are now faced with increased demands from a variety of shareholders that want to change the course of board decisions—and even the composition of the board itself.

As Securities and Exchange Commission Chair Mary Jo White observed in a speech she gave at Tulane University earlier this year: "The term 'activism' captures the range of efforts by investors to influence a company's management or decision making." She said that activism is used to "achieve a variety of outcomes: board seats or control of the board; an acquisition or spin-off of a non-core or unprofitable line of business; or a share buyback." White also noted that companies are communicating on a more regular basis with shareholders, including activists. That increase in engagement is generally a good thing and is a growing necessity for companies of all sizes today.

There are, however, downsides to activism, namely the costs and reputational damage associated with a shareholder publicly challenging a company, whether through a resolution on a governance issue or through a proxy fight to gain board seats. Furthermore, that damage extends beyond the company embroiled in an engagement; the rhetoric accompanying the shareholder activist movement can lower the public's trust in corporations in general.

A number of governance publications have featured forward-looking articles that enhance and encourage director education on the theme of boardroom disruption, most notably "Is a Disruptive Innovator Attacking Your Company?" by National Association of Corporate Directors (NACD) colleague Raymond V. Gilmartin *(NACD Directorship*, September/October 2015).

Here, I will focus specifically on board leadership as a positive disruptive force that could mitigate or lessen the negative impact of an activist investor—or even turn it into a positive influence. But first: a call to action.

A Force for Good

I urge the director community to take charge and aim for exemplary board leadership and strong corporate governance. I am optimistic about the potential influence and power that companies and boards can have to respond effectively to, and even get ahead of, today's tide of complaints about corporate governance. My outlook stems from the examples of scores of companies that are a force for positive change in society and the way that successful companies benefit their shareholders, other stakeholders, and communities. Clearly, the complexity of business today requires that corporate officers and directors commit themselves to continuous improvement.

As NACD develops its educational programming, directors in particular should be aware that a director's work is becoming more challenging, the agenda of board tasks is growing longer, and critics are getting bolder in making their cases for change in board governance actions.

I believe that the best way to counteract these pressures is for boards to perform beyond the expectations of their critics. This is a lofty goal, and yet, it is attainable if we are motivated to act for the benefit of shareholders, investors, and other stakeholders. To help sustain a healthy corporate sector, it is particularly important for boards to support strategic decisions that will ensure long-term value creation.

Boards have a comprehensive role that includes overseeing all

aspects of the corporation's work in addition to playing an advisory role and making specified decisions in key areas. Boards today need to excel in the traditional tactical, functional, and task-oriented governance work while also addressing critically important new issues that arise, such as cyber risks and shareholder activism. Managing these evolving sources of disruption requires visionary board leadership.

The following recommendations will enable boards to achieve excellence and distinction and to exceed the expectations of even their strongest critics.

1. **Understand the board's roles and responsibilities.** More than any other leadership function of being a director, I have reflected the most on the expectation that I act with integrity and am held accountable to my company's shareholders. I believe that to be effective in this era of increased shareholder activism, boards, individually and collectively, can benefit from updating their understanding of the board's roles and responsibilities. Making this review a part of our ongoing preparation for board work will provide a better foundation for engaging with both critics and supporters. For example, the board is expected to govern a company in the best interests of its shareholders and society at large. At first glance, disruptive shareholder challenges to board decisions suggest one of several things: the board is ineffective in performing its role and responsibilities; the challenger does not understand the company's strategy, objectives, and decisions; or a combination of these situations.

2. **Improve board-CEO relations.** The board plays a very different role than management and must be mindful of its three-part responsibility to oversee, advise, and act for the benefit of the corporation and its shareholders. When a board is described as being "strong," this means that the company has a board that leads and at the same time provides ample support and wise advice for the CEO.

3. **Sharpen board preparation.** Board preparation is a never-ending imperative. New issues that require board oversight and responsibility increase daily, and underscore the need for continuing education through either formal or informal avenues, chosen according to the preference of the boards and their individual members. While the types of new issues might vary by industry and company, they all have one thing in common: their numbers will continue to grow in our volatile and increasingly global environment.

4. **Enhance disclosures and communications.** For as long as I have been a director, figuring out how to oversee disclosure and communication functions has been contentious. Determining when and what to disclose is oftentimes as perplexing as whether to act ahead of a regulator's requirement to disclose. On the surface, disclosure is not an urgent matter for boards, but it continues to be worrisome, especially for boards that strive to show strong leadership. Strong boards realize that disclosure can easily become a reputational matter, especially when the company is getting adverse publicity because of a problem. In these situations, the public collectively asks: "Where was the board?"

Because boards are expected to be accountable for the conduct of their companies, they must both collaborate with the CEO and proactively communicate with the public before a crisis occurs. Communications should be part of the board's ongoing dialogue and its preparation to reach out to any and every audience, be it formally through organized professional channels or informally through interactions with community members.

5. **Deepen shareholder and stakeholder relations.** Management should develop strong and productive relationships with certain audiences. These audiences—large and small investors, investment firms, suppliers, customers, regulators, employees, and communities—therefore should receive special outreach and ongoing attention. Although it is always critical to maintain communications with large investors, be sure to pay special attention to the "small" or "retail" investors. An oft-repeated adage, usually in reference to cybersecurity experts, is "to know them before you need them." In an era when competition for votes in proxy battles is likely, small shareholders can be powerful allies.

Strong board leaders seek to make interactions and exchanges with all shareholders mutually beneficial. But how well do boards understand the expectations of shareholders? Directors need to think like an activist. Know that not all activists seek to accomplish their aims in the same ways. Strong board leadership helps management decide the appropriate response to any shareholder proposal or challenge, whether it is from an activist or non-activist shareholder.

6. **Strengthen board leadership.** Shareholder activism underscores the imperative that board leadership needs to be stronger than ever. Robust board governance ensures long-term, sustainable success for shareholders and other company stakeholders in our society. Only with strong management and board leadership can companies outperform the expectations of corporate critics.

The question remains whether strong board and company leadership will decrease future activist disruptions that target board governance decisions. Although strong board leadership will lessen these attempts, I do believe that strong management and board leadership before and during conversations with shareholders and stakeholders will result in more favorable outcomes for all. D