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A High-Quality Board is Key to Successful Activist Defense

When an activist investor declares they have a stake in a company and sets out the changes they're seeking, the track record of the target company's board suddenly attracts very public scrutiny.

Being under the microscope in this way can be perceived as a personal attack, and the tension is particularly acute when the activist is seeking a change in strategy that the board disagrees with. For example, Barclays' board last year rejected a request from activist shareholder Edward Bramson to join as a non-executive director because it opposed his push for the U.K. bank to scale back its investment banking business. Now, his appointment is expected to go to [a shareholder vote](#) at Barclays' annual meeting this spring.

However, even when there is disagreement over the activist's demands, there are good reasons for companies to examine their board-level decision making and oversight through an activist lens. Firstly, making necessary changes offers a proactive way for companies to transform their performance without giving away control or seats on the board. Secondly, target companies must forensically assess their governance because the activist has already done so.

"What activists really want to see is an engaged board, stewarding shareholder capital in an ethical way," says [Nate Dwyer](#), Managing Director with Alvarez & Marsal Corporate Transformation Services in San Francisco. This is where common ground between board and activist investor may be found, because "as a public company, your first and only allegiance is to the shareholders," he adds.

Before buying a stake in the company, activists will research how much shareholder value has been created during the tenure of various board member roles, as well as in their relationships between executives and independent directors, particularly those of long-standing. (The U.K.'s [corporate governance code](#) requires companies to explain how a director can still be considered independent if they have served on a board for more than nine years.)

"What the diligence activists do is not only on the operational and capital markets side but on the people side," says Dwyer. "There are background checks and there's an unbelievable amount of data they can collect."

A first step is for senior executives and board members to assess performance using the same measures as the activist (commonly return on invested capital or ROIC), so that they can weigh the validity of the proposed changes and be ready to answer questions when they arise.

When working with clients in an activist situation, "we have to have a fundamental handle on what's happening in the company, and speak the same language in terms of ROIC," says Dwyer. "We prepare the management team, so that they feel comfortable having the conversation with any top shareholder."

In conjunction with that detailed analysis, companies must be honest with themselves about the way they make decisions on spending shareholders' money. "If the answer comes back that two people on the golf course agreed to make an acquisition, then the right governance is not in place," says Dwyer.

Even when a target company is shown to be vulnerable on corporate governance, in most cases, it will still hold the upper hand when it comes to industry expertise and practical experience.



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FROM THE INSIDE OUT

“Most activists don’t have a core competency in execution,” says [Jim O’Donnell](#), Senior Director with A&M Corporate Transformation Services. However, “they’re confident they can bring people in who will run the business better than those on the board now.”

To prevent that from happening, boards should not dismiss activists outright, but instead work hard to answer their claims, whether that means providing evidence to refute them and secure the backing of other major shareholders or acknowledging that change is required and subsequently taking action to improve performance and returns. Meeting part of the way can be a solution. Boards can offer a couple of seats rather than full board control or provide access to confidential information rather than a board role.

“There’s a compromise between all of the demands and we do our best to find a notion of peace,” says Dwyer of A&M.

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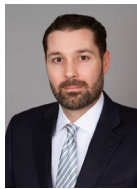
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JOE BERARDINO
jberardino@alvarezandmarsal.com



MALCOLM MCKENZIE
mmckenzie@alvarezandmarsal.com



NATE DWYER
ndwyer@alvarezandmarsal.com



JIM O'DONNELL
jodonnell@alvarezandmarsal.com

For general inquiries, please email us at corptransformationnewsletter@alvarezandmarsal.com

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