DEAL LAWYERS

Vol. 8, No. 2 March-April 2014

The Board's Evolving Role in Shareholder Communications

By Matthew Sherman, President & Partner of Joele Frank Wilkinson Brimmer Katcher (www.joelefrank.com)

Until recently, investor communications fell solely under the purview of a company's management team. The Investor Relations Officer, working together with the CFO, managed routine interactions with existing and prospective shareholders, and the CEO typically interacted with shareholders during quarterly conference calls and at key industry or investment bank-sponsored conferences. While boards wanted to know that the management team engaged regularly in IR, rarely did they play any role in the effort.

Given the increasing levels of shareholder activism at corporations both large and small and across industries, public company directors are now much more involved in investor relations than ever before.

Shareholder activism is here to stay and boards have taken notice. Boards and management teams are routinely being challenged—both privately and publicly—by investors, sell-side analysts, industry experts and regulators, to name a few. Companies today are finding that every decision is scrutinized—from executive compensation, corporate governance practices and capital allocation to the management team's ability to develop, implement and execute its strategic plan. Boards and management teams that are perceived to be lax or indifferent in addressing these critical, top-of-mind issues often face public opposition and proxy challenges by activist investors.

Activist investors have been increasingly successful in convincing other mainstream investors and influential proxy advisory services that change is warranted and that "fresh perspectives" are needed in the boardroom to effect such change. With activist investors emboldened by their influence, boards and management teams are taking control, especially on the IR front.

Good companies engage with their shareholders regularly—this is simply good investor relations. Companies must foster and maintain long-term relationships with their top investors so there is a means to communicate directly and effectively and to solicit honest feedback that can be used to inform the corporate strategy. Whether a company is facing good times or bad, it would be a mistake for any management team to meet with its institutional shareholders for the first time during an activist campaign.

In this new environment, boards are not only proactively assessing and addressing perceived structural or governance vulnerabilities, but they are devoting more time and resources to investor relations. Directors are developing and nurturing relationships with a broad range of key constituents, especially shareholders. Directors want to understand investors' perspectives, and in a number of instances, hear from them directly.

There are a number of scenarios during which direct interaction between Board members and shareholders is appropriate and useful. Generally speaking, if a management team is on the road speaking about a board initiative, it can be helpful for investors to hear a director articulate the board's perspective firsthand. In addition, at smaller companies, where the senior leadership team may comprise a smaller group of individuals, having board members speak directly to investors can help showcase the depth of senior level talent beyond the management team.

In specific scenarios, such as a proxy fight, board members play a critical role in the communications effort with the goal of demonstrating alignment between the management team and the board and support of the overall corporate strategy and direction.

Board engagement with shareholders outside of the proxy process is occurring more frequently due largely to institutional investors becoming more vocal about their own governance guidelines and analysis. These investors often do not rely solely on the recommendations of the proxy advisory services.

When appropriate, we advise clients to support controlled board communications with investors to create relationships that can be leveraged if and when needed. We have found that shareholders are most interested in the board's input when there are substantive issues to discuss and a board-level perspective is warranted.

Ahead of any meeting with investors—activist or otherwise—directors must be fully informed. Board members should be armed with, among other things, details about prior engagement with the shareholder, the shareholder's investment focus and history with the company as well as any public or private statements that the shareholder has made about the company. We advise directors to run through mock Q&As and other role playing exercises to prepare for investor meetings and that all parties agree on the boundaries for a conversation—and how far directors should be willing to go on key topics.

At the end of the day, the management team is in charge of the company's operations and is responsible for implementing and executing the corporate strategy. Providing investors with direct and unfettered access to the board could serve the unintended consequence of undermining management's authority and credibility.

That said, periodically and strategically utilizing a board member in a company's investor relations program can help support that company's effort to build a track record of open and transparent communications with shareholders and analysts. This in turn can provide a board and management team with critical in- sights into the mindset of its investor base, bolster that company's credibility and corporate governance, and in certain instances, head off any interest or approach from an activist investor.