# Don't wait to build trust

**ABE FRIEDMAN, corporate governance expert and founder of advisory firm CamberView, tells Brunswick's GEMMA HART and JAYNE ROSEFIELD how early engagement with investors can win activist fights**

**What are the most important elements driving the trends in activism now?**

Index funds now represent the biggest category of investors on Wall Street and activists can't be successful without them. Three big factors are changing the way this community of big institutional investors behaves and they underpin the current trends in activism.

First, 30 years ago, institutional investors voted their shares in the mail room. Proxy voting was not viewed as important. At that time, index funds were only just coming into existence and investors who didn't like the way a company was operating would just sell their shares. With the dotcom bubble, the scandals at Enron and WorldCom, and then the financial crisis, clients began asking the index fund managers, "Aren't you one of the largest shareholders? Are you asking these companies the right questions? Because this is having a big impact on us." The index funds couldn't just sell the shares the way a managed fund would, so they responded by setting up corporate governance teams to do a more thoughtful job on voting and engagement.

Second, during the financial crisis, stocks tumbled, but activist funds were doing reasonably well. So a lot of money began flowing into them.

Third, companies historically didn't make an effort to get to know the people who were voting their shares – because shareholders weren't voting against companies. Meanwhile, activists were aggressively courting corporate governance teams, learning how they think and developing relationships over the course of a decade. They established an ongoing dialogue with the voters.

That created a real imbalance of influence. Now, companies are realizing that they need to get to know who these voters are and what drives them.

**How do corporate governance teams compare to other investors?**

The people in governance often think differently from portfolio managers or analysts. They have no interest in hearing how your quarter went or how your year went. They want to understand how you are operating the company and whether you are structured to do that in a way that protects and enhances shareholder value over the long term.

Most portfolio managers have maybe 50 or 100 stocks in their portfolio. They know those companies inside and out. Large index managers, on the other hand, will vote at about 15,000 shareholder meetings a year. With that many, they just can't know each one in the same way.

So you have to go to them and explain your business, without talking down to them. And you have to talk about the things they care about.

**What do they care about?**

Investor rights. Is this a board we can trust? Then in every company there are things that they'll drill in on, such as pay or strategy or governance structure. It's not that hard to build a relationship with them, but you need to know how they think. Governance teams typically can only meet with you once or twice a year, so it's important to show that you understand them. It can take years to unwind a bad impression.

PORTRAIT: PETER FIELD

# Q: An activist takes 5 percent of your company's stock. How do you respond?
# A: Don't wait until they have 5 percent

**Index funds often vote with activists now. Has the pendulum swung too far?**
In the past year or so, the trend has been toward companies settling because they don't want to deal with the distraction of a long activist battle. In the last nine months, I've been hearing a growing backlash against these settlements. Institutional investors want companies to be discerning with activist demands, not just cave in.

**An activist takes 5 percent of your company's stock. How do you respond?**
Don't wait until they have 5 percent. The activists have built really strong connectivity with voting shareholders. Before an activist comes, companies can level that playing field by doing the same.

The activist demands will have two sides. One will be specifics for how to improve returns – split up the company, fire the CEO, reallocate capital or whatever. That is necessary, but not sufficient. Second, the activist will always add, "By the way, you can't trust the board to do this. The only way this gets done is if I'm in the boardroom or my slate is in the boardroom."

Most companies don't take the boardroom threat seriously enough. But the reality is, if the activist doesn't get both, he doesn't win.

**So the best defense is building trust with those who ultimately cast the votes?**
Yes. If you can get to the people who vote your shares before the activist does, it is unequivocally better for you.

**In the heat of battle, do you have any tips about framing the company message?**
A small group controls 65 percent or 70 percent of the vote. So there are only 30 or 40 people who are either going to support the activists or support the company. The focus needs to be on those people. It helps to have an easy-to-grasp message, as in the infographics used in the eBay fight (see Page 13). Simplicity and clarity are important. Win with your message, rather than by attacking the activist.

**If management responds to an activist by saying, "We looked at that, but long term it's not in our best interests," does that appeal to investors who are focused on governance?**
Yes, absolutely. If you can frame the activist agenda as a short-term plan and yours as a long-term one, that's persuasive. The governance folks are "buy and hold." BlackRock, for example, manages something like $3 trillion of indexed funds. They're going to be in these stocks for 50 or 100 years. They want good, long-term, sustainable performance.

**How do the companies that are winning use their management and boardroom resources?**
First, they have a constant line of communication open between management and their investors, and a back channel between their investor relations and the institutional shareholder voters.

Second, the role of directors is becoming more important. For example, in the context of a pay challenge, you really need to get a member of your compensation committee in front of investors. The argument on a pay vote comes down to trust in the board. The voter should walk out of that meeting thinking, "Well, that's not exactly the way I would do it, but I trust them. Their decisions are sensible and focused on the needs of investors." Then you've won.

**Index funds** are a passive form of investing, designed to generate the same rate of return as an entire market index. They differ from managed funds in that they generally only buy and sell shares in order to match the weighting of the index they are tracking

**GEMMA HART** and **JAYNE ROSEFIELD** are Partners in Brunswick's New York office, specializing in mergers and acquisitions, and shareholder activism.

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## CAMBERVIEW

Founded in 2012, CamberView supports public companies dealing with complex and contested shareholder matters, specializing in corporate governance concerns. The firm is headquartered in San Francisco.