

IR Insight

*Prepared by Tokyo consultancy
Investor Impact, Inc., IR Insight
provides analysis about the latest
IR trends and recommendations
on communications strategies that
positively impact corporate value.*

January 2015



■ IR Global Trends: Activism and Corporate Governance

—Key Points of National Investor Relations Institute Senior Roundtable Conference
2014/2015 (Part 1 of 2)

In this and the next issue of *IR Insight*, we summarize some of the key points discussed at the annual U.S. National Investor Relations Institute (NIRI) Senior Roundtable Conference, which was held from December 3-5, 2014. Attendance at the annual roundtable conference is limited to NIRI members with 10 years or more experience in investor relations (IR). Increasingly, the NIRI roundtable is playing a leadership role in the IR profession and providing guidance to the U.S. Securities and Exchange Commission (SEC) and other public and private institutions on the proper course of development of IR practices. Topics discussed at the conference included dealing with activist shareholders, the relationship between activism and corporate governance, evolution in the communication between corporate issuers and institutional investors, the continuing rise in the importance of sustainability and other forms of non-financial reporting, as well as the growing role of IR officers (IROs) in reporting to the CEO, CFO, and other members of board of directors on the views of institutional investors.

Dealing with the Rise in Investor Activism

As in 2013, one of the most-important topics at the 2014 NIRI Senior Roundtable Conference continued to be dealing with the rising level of activism among investors. According to surveys conducted in the United States, the number of activist campaigns mounted to change corporate management policies regarding such issues as asset allocation and board of directors' membership has risen steeply since 2009, when the figure was less than 50, to nearly 200 in the first half of 2014 alone¹. The value of funds

¹ IPREO: "Activism, Ready or Not"

under management by institutional investors classified as activists has also reportedly risen sharply as well.

Surveys also suggest that the rise in activism is not about to weaken. On the contrary, 89% of respondents to one survey think activism will continue to rise². About 63% replied that negative investor perceptions are the most-important characteristic of an attractive activist target, and 69% would support activists by investing in previously commenced activist situations.

Some of the comments of participants at the conference and in previous NIRI webinars included:

- “The main thing is that activism works. Institutional investors are often supportive, although they may not be classified as activists. So, when a campaign appears likely to succeed, a broader range of investors may buy into the company that is under attack.”
- “The number of activist investors and the number of campaigns are increasing. I have counted about 1,000 campaigns over the last decade.”
- “Part of the success of activist campaigns may be due to aggressive use of social media, including Twitter, but both regular media and social media are rising in importance.”
- “This year, even large companies, including Apple and eBay, came under attack. Size does not offer protection anymore.”
- “Activist campaigns are spreading overseas from the United States.”

In the discussion of the factors that may contribute to making a company an activism target, participants at the conference mentioned:

- **Underperforming share prices:** Most activists are value investors who look for companies with relatively weak performance compared with their peers.
- **Problems in resource allocation:** Activists look into how companies allocate their resources. They ask questions such as “Where is the cash going?” and “Is the company spending too much on R&D and reluctant to make transparent assessments of the contribution of their R&D spending?”
- **Compensation:** Is executive compensation too high, even when performance declines?

² FTI Consulting

- **Corporate governance:** Is the board making appropriate contributions to strategy formulation and steering the company to benefit the shareholders with an eye to the short and long terms?

Reportedly, activist investors identify a range of companies that appear to have or are likely to have such issues as those listed above. They then research and follow these companies, typically, over several years. This involves talking to a range of interests on the periphery of these potential target companies, including customers, suppliers, retired employees, competitors, and others.

Activists with good intentions, who are interested in increasing corporate value in the medium-to-long term, generally formulate suggestions, based on thorough research, which they can present to the management of the target company. If the company is receptive to hearing the presentation, in the best of cases, this may open the way to constructive discussion. On the other hand, “dissident” activists, whose aim is usually short-term gains, may be interested only in making suggestions to raise stock prices in the short-to-medium term, such as stock buybacks and raising dividends. After their shorter-term goals are achieved, they sell their stock holdings.

What are companies doing to prepare for dealing with activists? In our report on the 2013 NIRI Senior Roundtable Conference, we noted that participants recommended:

- Analyzing the shareholder base to determine the presence of activists.
- Identifying those with investment styles based on good intentions and classifying them separately from dissident investors.
- Analyzing your own company’s vulnerabilities as seen from the activist’s point of view.
- Preparing plans for dealing with your activist investors most effectively.

Additional suggestions made by participants at the 2014 NIRI Senior Roundtable included:

- **Determining the root of issues** that the activists are raising. Can a reasonable solution be worked out before the matter is covered by the media?
- **Designating a board director to be the spokesperson** and coordinator for PR activities related to the issues raised by the activists.
- **Engaging the best and brightest advisors.**
- **Exploring possible compromises.** Can a compromise be reached at an early date by making some concessions?

- **Maintaining regular communication** with all institutional investors, including not only active funds but also passive (index) investors.
- **Following activism trends** on a continuing basis.
- **Most of all, being prepared.** Participants at the conference with firsthand experience in dealing with activists emphasized that the company under activist attack must be ready to react appropriately. The first and subsequent reactions are crucial in setting the tone of future interaction.

Links between Activism and Governance

Issues related to corporate governance are often the cause of activist attacks. One example cited was a well-known motion picture company where the founding family still held strong control over board memberships and some other aspects of corporate management. Although a mandatory retirement age for directors of 72 had been set by the company in the past, members of the founding family decided to stay on beyond the mandatory age. According to the speaker, who had been close to the IR function, this caused a distraction at board meetings and prompted investors to lower their evaluation of the company's stock.

The participant citing this example also gave his views on how the situation should have been handled. First, the board should have had an independent party analyze the reasons for the deterioration in the company's stock price, including a perception study among investors. The board should then have considered the results objectively and taken appropriate action. Under the circumstances, however, the board chose the course of letting time address the issues involved and explaining their position on the composition of the board of directors to investors directly through meetings with fund managers and analysts.

Another course of action related to corporate governance taken by activists is to actually seek one or more seats on the board. As pointed out earlier, courses of action to persuade activists to soften their position would include careful analysis of the position taken by activists to determine whether their objectives might be accomplished without actually having their representative sit on the board. Another suggestion would be to appoint one member of the board as spokesperson to investors not only for IR matters but also for overall PR activities. This would serve the function of acting in a conciliatory manner toward the activists and, at the same time, control information flows and giving them the proper perspective to accomplish the company's objective of continuing to create shareholder value.

After all, at the end of the day, the role of corporate governance is to exercise discipline on corporate management. On the other hand, IR is an activity that promotes growth in corporate value and improves the conduct of corporate management through reporting on a company's business activities to its shareholders and, thereby, providing the discipline of exposure to the shareholders' evaluation. This strongly suggests that as Japan's corporate governance revolution proceeds and corporations put governance into practice, IR activities will assume a considerably more-important role in increasing corporate value.

Prepared by C. Tait Ratcliffe, Chairman & Representative Director, Investor Impact, Inc.

*** **

Feel free to contact the following with your comments on or questions about IR Insight:

C. Tait Ratcliffe

Tel: +81-3-6417-4932, Email: tait.ratcliffe@investorimpact.com

Thomas R. Zengage

Tel: +81-3-6417-4933, Email: thomas.zengage@investorimpact.com

Rika Sumi

Tel: +81-3-6417-4935, Email: rika.sumi@investorimpact.com

Investor Impact, Inc.

8th Floor, Gotanda KY Building, 2-18-2 Nishi-gotanda, Shinagawa-ku, Tokyo 141-0031

Tel: +81-3-6417-4930, Fax: +81-3-6417-4931

Email: info@investorimpact.com, URL: www.investorimpact.com