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Companies' true essence visible in the Covid-19 crises

Schulte Roth & Zabel pros discuss shareholder activism

BY ELE KLEIN AND ANELIYA CRAWFORD, SCHULTE ROTH & ZABEL LLP, 21 APRIL 2020

The Covid-19 crises is a challenge for all economic participants – investors, companies, the economy and most notably everyday people.

Most individuals and entities are rising to the occasion. Investors are protecting investments and seeking safety, and companies are looking to lead and take care of their employees and other assets.

But a crisis is also a time for companies, particularly those not up to the challenge, to welcome shareholder input and build consensus around an optimal strategy. It is not a time to use the crisis as an excuse to dust off entrenchment defences and consign shareholders to suboptimal strategies and underperformance.

Poison pills are not the cure

It is bewildering to see advisors tell companies that they must adopt poison pills to protect themselves from unfair "hostile" activity.

Recent reports by Deal Point Data cite at least 21 poison pills being adopted by US companies in March 2020, the most in any month since January 2017 when they began to track data, and triple the previous most active month of January 2018. And the pill antidote wave is still in progress.

Activists do not run campaigns to seek to influence or control companies for the sake of influence or control. Activists (and these days investors of all stripes) identify companies that are underperforming their peers and their potential – especially in times of stress. Campaigns are pursued to inject value into these companies and provide them with needed expertise to survive and succeed.

Investors beware. For one, in these turbulent markets, trends have not fully emerged yet. Investors' approaches to dealing with the volatility are as varied as their investment strategies, portfolio compositions and capital sources. While acquisition programmes are not abandoned and we have seen some notable increases in stakes, it is hardly true, at least from our vantage point, to say that there is a wave of opportunistic hostile minded investors who are gobbling up vulnerable companies to take advantage of their dire straits.

Activists like all investors buy stock that they view as underpriced because they are confident in the prospects of the company to weather the current crisis and any short-term downturn and eventually be worth more in the future. What makes underperformers vulnerable is not a market- wide or industry-wide dip in the prices but their relative prospects and inability to manage the crisis.

Investors should be aware that these difficult times can be and in some cases are being used by their portfolio companies to excuse the adoption of governance unfriendly features that undermine shareholder rights. The time of crisis is no time to isolate leadership from shareholder input. It is a time when shareholder input is more important than ever.

Well-managed companies lead; mismanaged companies entrench

In times of crises, true colours emerge. Well-managed companies show what true leadership means, protecting employees, assets and investors will be looking to position the company as best as possible.

Unfortunately, not all companies are well managed and many companies have done the opposite. There is widespread mishandling of the Covid-19 crisis and the threat it poses to businesses.

We are seeing companies dropping shareholder representatives off their boards, leaving activist-backed directors out of critical strategic discussions and overall blocking shareholder involvement in every possible way.

Ironically, it is the companies that close ranks the most that are mishandling the crisis the worst and are in most desperate need of the help shareholders can provide to them.

Not surprisingly, some of those underperforming boards and management teams are self-servingly claiming that this is not the time for change.

The argument is that they should be left to focus on dealing with the crisis, uninterrupted by the ideas of their owners and the owners' representatives on the board. Once again this is shortsighted and misunderstands why shareholders run campaigns for change. It is in the context of crisis that the need for change and shareholder support is most urgent at those very companies that lack the ability to do it on their own.

Investors seeking to protect the value of their investments will be well advised to remain vigilant about the governance of their portfolio companies. They should not give a pass to undeserving boards and management misusing the crisis to isolate themselves from accountability.

They should also not hesitate to move boldly to make changes at companies that need them or support others who are pushing for changes. Well-run companies earn deference — poorly run companies need change, especially in times of crises. The Covid-19 context may be the most important time to make these changes as vital decisions are made, the stakes are high and the urgency is greater than ever.

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