HARVARD BUSINESS LAW REVIEW

Foreword

SHAREHOLDERS IN THE BOARDROOM

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I am delighted to have been asked to write the foreword for this issue of the Harvard Business Law Review, much of which is focused on the continuing debate about shareholder activism. The topic is certainly timely—the level of shareholder activism continues to increase, with many new activist funds on the scene, a flood of new money being invested in the strategy, and countless investors who are otherwise passive now trying out activism on an occasional basis. We survey activist investors and corporate executives every two years to gauge their views on activist matters, and in our most recent survey both groups expected that the level of shareholder activism would increase for the foreseeable future.

The responses to one question in our survey are most revealing about why the activist battles will continue, as the question went to the heart of shareholder activism and the answers reflected the widest difference of opinion between the two groups of any we asked. The question was whether the respondent believed it is appropriate for shareholders to have board representation. Not surprisingly, 100% of the activist respondents said yes. But fully 64% of the corporate executives said no. When we asked the same question of corporate executives in 2010, 74% said no.

That corporate managers believe it's inappropriate for the owners of their companies to have representation on their boards is somewhat surprising. After all, every public company started as a successful private company, where founder-owners dominated their boards. And these managers regularly embrace the potential wealth-creating opportunities offered by private equity take-private transactions, where owner representatives will again dominate their boards. Yet, while public, they just don't want shareholders in the boardroom.

Why do they have this view? Admittedly there are legitimate issues with shareholders becoming directors. Will they really be representing the views of the shareholders generally, or just their individual agenda? How much stock should they have to own, and for how long, to "merit" a board

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seat? How would you pick between multiple shareholders, with different ownership levels, holding periods and agendas, all of whom are looking for board seats? What if they sell their stock after getting on the board?

But I doubt that these are the primary concerns that lead to the corporate managers' aversion to stockholders in the boardroom. More likely, I believe, is that they simply don't want to be challenged by a board member they view as an outsider—an interloper disrupting the collegiality in the board room—with ideas for value creation that they disagree with. After all, when shareholders suggest to a company some action it should take to maximize value, it's rarely an action that the company's management hasn't already considered and rejected. When activists press the point, managements have been coached to respond that they welcome the shareholder's investment and are always interested to listen to their shareholders' views, but at the end of the day, they typically sincerely engage only when the shareholders' suggestion is coupled with the threat that if it is ignored, it will seek board representation. And when the companies agree to take the suggested action or otherwise settle, it may only be after they've been advised by their proxy solicitor that they'll lose an election contest if they don't. All too often it is their desire to keep shareholders out of the boardroom that brings them around.

Another justification cited to keep shareholders, and particularly activist shareholders, out of the boardroom is that their ideas are too short-term focused, whereas the board's job is to create value over the long term. While activists more recently have pressed for operational turnarounds for long-term value creation, there's no denying that their demands often are for quicker fixes (sell or split up the company, cut expenses, sell non-core assets, return capital to shareholders) that will produce immediate value. But they're typically making those demands to companies that have failed to create (or even destroyed) shareholder value over the longer term, as those are the companies with a dissatisfied shareholder base which distrust management's ability to execute and will support the activist position.

And so it goes. There's unlikely to be peace between corporates and activists until corporate managers truly believe their own rhetoric and welcome the shareholders' viewpoint, even in the boardroom. Until then, the fighting—and the debates—will continue.