Striking the Right Tone for Activist and Overseas Engagement

By Jesse Rhodes

The National Association of Corporate Directors (NACD) and FTI Consulting recently hosted a prestigious group of directors at the Harvard Club in New York City to discuss two major issues facing boards: activist investors, and mergers and acquisitions (M&A) in foreign markets.

What to do when confronted with an activist investor is arguably one of the biggest issues a board will face. While a contest or proxy fight may not be completely unavoidable, Steven Balet, a managing director in FTI Consulting’s strategic communications practice, noted that proper engagement is critical and can help a board set the tone for how interactions with the activist will go.

“What frustrates activists is a sense that the conversation is one-sided and that they aren’t making any progress. Having a member of the board involved in the initial or follow-up engagement helps,” Balet said. “If a board ultimately decides that the activist’s outlined plan is not in the best interest of the shareholders, having had an open and honest engagement deprives the activist of declaring just the opposite to investors and proxy advisory firms such as ISS [Institutional Shareholder Services].”

Balet also warned that increasingly active activist investors develop relationships with institutional investors due to their repeated contact during activist engagements. “Management and boards may speak to certain, more passive investors just once or twice a year, while activists are interacting with these investors five to eight times a year,” he said. This is increasingly important as activists have largely shifted away from a “sell the company” tactic to a “balance sheet” approach that calls for more divestitures, buybacks, increased dividends, and, in general, a capital allocation stance designed to return as much cash as possible to shareholders—including advocacy of companies taking on leverage to accomplish this goal.

The conversation then moved to global M&A. Gaining a foothold in foreign markets through an acquisition is an exciting growth opportunity for any company. Yet ensuring that an overseas venture is successful requires more than sheer business sense. It requires sensitivity to the human elements at play—a frequently overlooked facet of international expansion.

Understand the community in which you do business, advised Andrea M. Esposito, co-chair of the Financial Women’s Association’s directorship and corporate governance committee. Drawing on her own experience in international ventures, Esposito said: “If some of you haven’t worked in these small, emerging markets, you must realize there is a limited, elite, interconnected business community that runs most of the companies. In the beginning of building our entry into these markets, I used cultural exchanges, where a few of our key employees would be sent to our New York office for six months to be inculcated into the importance of our company’s ethics and culture, and at the same time have some headquarters staff work in the local setting for short stints to understand the local market’s unique intricacies.”

Jean-René Gougelet, director at Trudeau Corp., agreed: “M&A fails miserably because people think that we all speak the same language. I’ve seen a lot of French corporations making large acquisitions in the United States and basically losing half of what they had invested. It was basically a matter of culture.”

Neal Hochberg, senior managing director and global leader of the forensic and litigation consulting (FLC) practice at FTI Consulting, emphasized the importance of fostering an environment that stresses compliance with federal and international regulations. Many companies make the misstep of not investing in compliance monitoring and then assume that all is well—that is, until issues begin to arise. This can be especially problematic when a company tries to establish itself in high-risk emerging markets and sets unreasonable revenue targets that could prompt illegal behavior when executives
try to meet those goals. Companies that don’t invest in proper prevention are taking a heady reputation risk. “Ensuring that the company is proactive in putting a compliance program in place to protect enterprise value pays dividends over and over again in respect to avoiding a nasty government regulatory inquiry,” said Hochberg.

“Public company directors also need to be very concerned about compliance with the Foreign Corrupt Practices Act (FCPA),” said Basil Imburgia, senior managing director and North American leader of the FLC practice at FTI Consulting. “As protecting a company’s reputation is of utmost importance to today’s global organization, it is critical to continuously design, test, and monitor internal controls policies and procedures, both proactively (risk assessment) and reactively, after an event has occurred.”

While the government is primed to prosecute companies that violate the FCPA, one participant drew on his experience working on an international trade advisory committee to point out that the federal powers-that-be aren’t always out for blood. “The government is willing to help you make sure that you don’t get in trouble, and when you do get in trouble, they appreciate it if you do voluntary disclosure,” said Jill J. Wittels, CEO of Sostenuto Strategic Advisors. “A company probably doesn’t recognize that it has blemishes, so it’s better for them to come forward and say, ‘We didn’t see the red flags, but these are the precautions we put into place in order to make sure that we don’t have that problem in the future.’”

In response, one director questioned whether due diligence and voluntary self-reporting would mean smoother sailing through a federal investigation. “If you’re looking at M&A, you have to be so careful,” she observed. “You could be buying a company that was guilty of FCPA violations, and if you don’t figure that out in the M&A process, that is in your lap.”

Having witnessed firsthand M&A in the aerospace industry, she recalled an instance when a company that played by the book acquired a company managed by someone who had been acquiring insider information from government procurement officials, and the practice continued after the merger. “I think it’s an open question in the end whether they’re still not going to get whacked for the situation because it continued after the acquisition,” she said.

FCPA guidelines released jointly by the U.S. Department of Justice and the Securities and Exchange Commission in 2012 established the expectation that boards would play a greater role as overseers of what management is and is not doing. Are board members overreaching their responsibilities by keeping tabs on what’s happening on the ground? “No,” said Frank Gatti, director of Peoples Educational Holdings. “I would certainly urge folks to think about not only the tone at the top but the mood in the middle and the buzz at the bottom,” he said. “As a board member, you really need to figure out ways to do that and not just rely on management, because you’re going to get three different answers of what the FCPA policy is at those three layers in the cake.”