

# The best defense is a good offense

“Today you need real substantive preparation  
and real (investor) engagement.”

**FALLS**  
COMMUNICATIONS

For centuries, strategists and philosophers have espoused that “the best defense is a good offense” for the simple reason that “when you are constantly in a defensive posture, you can seldom win.”<sup>1</sup> While this philosophy has been embraced by business leaders, it has been adopted less enthusiastically by communications officers, particularly those responsible for investor relations. This is surprising given the growing success and influence of social and investor activists (see fig. 1), not to mention the significantly increased competition for capital in general.

It’s been our experience that many companies miss their best opportunity to create a competitive advantage in the global financial markets – let alone maintain a level playing field – by treating investor communications essentially as a compliance function. Among other things, this defensive mindset prevents companies from developing a strong “investment brand” (see more about the investment brand on page 2) needed to engage investors and enhance enterprise value more effectively.

Think about it: would you allow someone else to define the value of your products and services to customers? Of course not! So why would you let someone else define the value you offer investors?

That’s essentially what you are doing when you only play defense in your investor relations strategy. And this defensive stance can play right into the hands of the activists you seek to avoid.

## Anatomy of an attack

According to Holly J. Gregory, a partner with Sidley Austin LLP and consistently among the “100 Most Influential Players in Corporate Governance,” according to *Directorship* magazine, “Activists often use a company’s short-term performance problems or perceived governance, compensation, ethics or compliance issues to attract support from institutional investors ... generally, activists seek to increase the value of their investment in the company by pressing the board and management team to make changes.”<sup>3</sup>



Percent of proxy fights that resulted in board representation for the activist investor in 2013 versus 43% a year ago.<sup>2</sup>

fig. 1

Let's take a closer look at what Ms. Gregory said:

- “short-term performance” – not performance over time or anticipated performance going forward
- “perceived [issues]” – which may or may not be real
- “increase the value of their investment” – not the future value of the company over the long term
- “pressing the board and management team to make changes” – often change for the sake of change, and equally often without consideration to the board's and management's previous deliberations or actions

It's not difficult to connect these dots. Activists exploit unflattering snapshots of a company through “sophisticated public relations and media campaigns,”<sup>4</sup> as well as opportunistic investment and legal strategies, to advance their own agendas. In many ways, it's a war of words. Sadly, too many companies are not making their words count.

“The brute force of ownership is not required anymore because the big institutional players listen to both sides and are willing to back the activist fund if they believe in them,” said Gregory P. Taxin, president of the \$1.5 billion hedge fund Clinton Group. “You can win with persuasion and ideas.”<sup>5</sup>

## The more we sweat in peace, the less we bleed in war<sup>6</sup>

Few companies today are immune to activist attacks<sup>7</sup> as activists have too much money and too much momentum to scale back now. As a result, “[t]he bunker mentality that had been advised in some quarters is fading as an approach,” said James C. Woolery, deputy chairman at Cadwalader, Wickersham & Taft. “Today you need real substantive preparation and real [investor] engagement.”<sup>8</sup>

So just as companies and their lawyers and bankers go through rigorous “fire drills” to prepare for an activist attack, as well as “identify strategic weaknesses that they can fix...”<sup>9</sup> in advance of a fight, so, too, should companies regularly assess their investor communications for potential vulnerabilities. “To know your enemy, you must become your enemy.”<sup>10</sup>

For example, board diversity is among the top priorities for activist investors (just ask Apple<sup>11</sup>). Today “pale, male, stale boards ... [are seen as] a symptom of deeper problems of board governance.”<sup>12</sup>

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## MORE ABOUT THE INVESTMENT BRAND

**In order to engage investors and enhance value more effectively through communications, we believe companies need to complement and support the compliance mandate of investor relations with sophisticated branding and marketing strategies. By utilizing fully the “3Cs of IR” – compliance, context, channels – companies can create an authentic and differentiated “investment brand.”**

**Among other things, a strong investment brand can cut through the daily noise of stock traders and enable a company to make genuine connections with long-term investors. The investment brand not only reflects the central essence of the company but speaks to the company's competitive advantage.**

Look at how you market your board of directors in the proxy statement, on the website and elsewhere. Are you providing basic biographical information or are you proactively explaining how the experience of the board ties to and helps propel the company's overarching business strategy? If the former, then you are leaving the door open for others to editorialize freely and question the competency of your board.

"A well-designed proxy can cut through the clutter and allows the company to tell its story on its own terms. It also can help counteract the effects of a negative recommendation from proxy advisers..."<sup>13</sup>

Ms. Gregory has noticed more companies today using "the proxy less as a compliance document and more as an opportunity to communicate with constituents."<sup>14</sup>

## Your communications strategy should be designed both to accentuate your assets and neutralize your liabilities.

At the very least, establishing and protecting your investment brand will ensure you are not making it easy for an activist to mischaracterize you later.

To start your investor communications assessment, ask the following questions:

**1. Do we have a strong story to tell?** – Odds are you don't, as corporate storytelling is a lost art in the business world.<sup>15</sup> Your story is critical when communicating with investors as "[stories are] how we make [and] justify our decisions..."<sup>16</sup> It's no wonder that activist fund managers are now becoming "more proactive in telling their stories and actually caring about their brands..."<sup>17</sup> long before they initiate an attack.

Therefore, make sure you are telling an investment brand's story that goes beyond the "who" and the "what" of the company and digs into the "why" and the "how." Through discovering the "why," you will find what makes you authentic. The "how" will show you how you are differentiated from your peers.

**2. Are we telling our story enough?** – Your strategy should not be only about picking your shots but rather about maximizing the number of shots you take and making the most of each one of them. Your story should be told clearly and consistently in every investor presentation and news release. It should be woven into all of your executive communications, your investor literature and on your IR website. It also should help shape your media relations strategy. Likewise, your story should be front and center in your SEC filings, especially your proxy materials.

Educating the market is a primary responsibility of investor relations. And repetition is a critical teaching tool, particularly when dealing with a distracted and information-overloaded audience.

**3. Are we prepared to make our case?** – Since there are at least two sides to every story, your communications strategy should be designed both to accentuate your assets and neutralize your liabilities. When addressing the former, make sure you have quantitative and qualitative evidence that supports your positions. To the latter, build a defense for your vulnerabilities, including testimony from independent third-party experts, and watch closely how others in similar situations handle their issue(s).

Preparing your case – and proactively addressing shortfalls<sup>18</sup> – before attacks occur will give you a better chance at controlling the narrative and succeeding.

**4. How well do we listen to the market?** – It's hard to make your case if you aren't regularly taking the temperature of your constituents.<sup>19</sup> Furthermore, you should "monitor [your] peer group, sell-side analysts, proxy advisors like ISS, activist institutions like CalPERS and TIAA-CREF, Internet commentary and media reports for opinions or facts that will attract the attention of attackers."<sup>20</sup>

Renowned activist investor Carl Ichan thinks "[t]here has never been a better time for activist investing."<sup>21</sup> The numbers certainly support that claim as assets under activist management have almost tripled in the past five years to more than \$90 billion.<sup>22</sup> How your company fares in this environment will depend on a number of things, including how strong a defense you can mount – and how quickly you can mount it. In many cases, the best defense is a good offense.

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## Notes

<sup>1</sup> "Sun Tzu – The Art of War for Managers" by Gerald A. Michaelson & Steven Michaelson (Second Edition, 2010)

<sup>2</sup> "Activist hedge fund managers get board welcome," *Financial Times*, December 23, 2013

<sup>3</sup> "Preparing For Shareholder Activism," PracticalLaw.com, September 2013

<sup>4</sup> "Dealing With Activist Hedge Funds," Wachtell, Lipton, Rosen & Katz, November 2013

<sup>5</sup> "No Barbarians at the Gate; Instead a Force for Change," DealBook/*The New York Times*, January 6, 2014

<sup>6</sup> Vijaya Lakshmi Pandit, Indian diplomat and politician, 1900-1990

<sup>7</sup> "How to Profit From Today's Shareholder Activism," *Barron's*, November 30, 2013

<sup>8</sup> "Boardrooms Rethink Tactics to Defang Activist Investors," DealBook/*The New York Times*, November 11, 2013

<sup>9</sup> "Activist hedge fund managers get board welcome," *Financial Times*, December 23, 2013

<sup>10</sup> "The Art of War" by Sun Tzu, translated by Thomas Cleary (2005)

<sup>11</sup> "Activist shareholders' top priorities in 2014," CNN/Money.com, January 6, 2014

<sup>12</sup> "Investor pressure prompts Apple board diversification," *IR Magazine*, January 8, 2014

<sup>13</sup> "The Art of Proxy Design," BOARDMEMBER.COM, Fourth Quarter 2013

<sup>14</sup> Ibid.

<sup>15</sup> "3 Reasons to Master the Art of Storytelling," *Inc.*, April 9, 2012

<sup>16</sup> "The Psychological Power of Storytelling," *Psychology Today*, January 16, 2011

<sup>17</sup> "Hedge funds enter the brand-building era," *PR Week*, July 16, 2013

<sup>18</sup> "Dealing With Activist Hedge Funds," Wachtell, Lipton, Rosen & Katz, November 2013

<sup>19</sup> Ibid.

<sup>20</sup> Ibid.

<sup>21</sup> Ichan Enterprises L.P. Reports Third Quarter 2013 Financial Results, November 4, 2013

<sup>22</sup> "Activist hedge fund managers get board welcome," *Financial Times*, December 23, 2013

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