

Shareholder Activists — A bigger Threat than Strategic Buyers

A Strategic Communications
Perspective

A wave of activism is sweeping across the Atlantic

While the past decade has seen a steady increase of shareholder activism in the UK, the true battleground has been continental Europe, which has witnessed a dramatic surge in activity.¹ Meanwhile, the US, long the centre of activism, has seen the number of campaigns stagnate since 2016. The growing threat represented by shareholder activism is more than just anecdotal – idle chatter heard on the streets of Europe’s financial capitals.

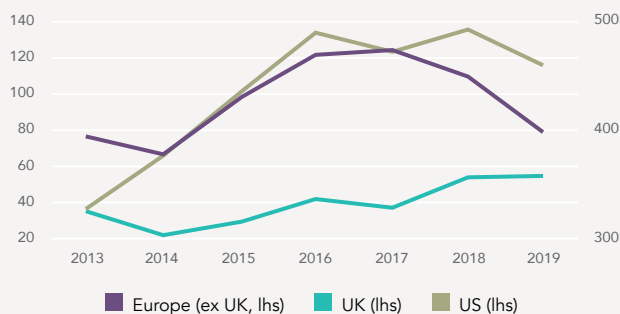
It is evidenced in the hard data and recent high-profile campaigns that clearly point to a wave of activism sweeping across the Atlantic, even if the number of attacks has dipped recently.²

As activism and companies’ reactions have grown more mature in the US, advancing from the easy pickings of the early days to more complex, protracted campaigns, US-based funds are now faced with a dearth of opportunities. This, combined with greater global diversification among European shareholder bases and the success of US and European activists, has created the conditions for activism in Europe to be a lasting presence. Companies and their corporate defence advisers ignore it at their peril.

In spite of all the evidence, many companies believe they are immune and need not prepare, taking institutional investors’ unwavering support as a given and convinced they have more important things to do.

Based on the data, that stance is imprudent. Those who already have the tools to deal with a defence against strategic buyers – that is, their peers and competitors potentially wishing to take them over in whole or in part – have already gone some of the distance towards preparing for an attack by activists. Some of the distance but not all, considering the similarities and the differences between the two groups of attackers.

Exhibit 1: Number of companies publicly subjected to activist demands, 2013-2019



Source: The Activist Insight Annual Review 2020

Key entry points used by activist investors

Let’s first look at the statistics on common activist points of entry. In 2019, activists used six main gateways, the most common being criticism of the board. This criticism, a broad one, might focus on the lack of independence or diversity of non-executive directors, the board’s size, the way non-executive directors are elected, an effort to gain greater representation and/or to eliminate existing board members, or separating the role of the CEO from that of Chairman.

inefficient or imprudent use of the balance sheet, excessive remuneration policies and ineffectual corporate strategy.

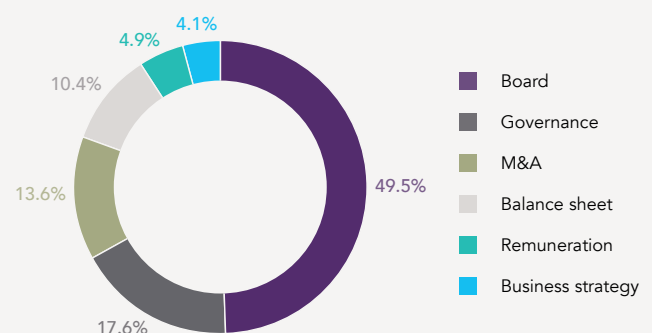
The second most frequent tactic is criticizing corporate governance, such as bylaws, board composition, reporting transparency or accuracy, tenure of an auditor, lack of succession planning, and the individual election of non-executive directors.³

Remarkably, in Europe the percentage share of these six approaches has been largely unchanged for years.

These two entry points make up two-thirds of all activist demands. Because replacing directors is the highest point of leverage for an activist, an attack on the board is almost a necessary component of any campaign. This does not mean, however, that the point can be ignored. Directors pay close attention.

The remaining third consists of criticism of corporate M&A activity (recently, often resistance against proposed transactions),

Exhibit 2: Activist demand groups in Europe, 2019



Source: The Activist Insight Annual Review 2020

1. Activist Insight: <http://www.activistinsight.com/>

2. The other recent hotbed for activism is Japan. For further insights on activism trends in Japan see <https://www.kekstcnc.com/insights/shareholder-activism-in-japan-the-new-global-hotbed>.

3. An interesting question we cannot explore here, is the impact of the US/UK-style governance models (unitary board) vs German-style dual board on activists’ activity and approach.

M&A and activist defence plans: similarities and differences

What are the questions companies should ask themselves as they prepare to mount a defence against potential strategic buyers? In essence, there are four:

01

Do we have an unassailable, coherent **strategy** in place, is it clearly communicated, and do our investors understand and support it?

02

Do we have best-in-class **operations** that are on a par with our best-performing listed peers?

03

Is our **financial performance** and position, revenue growth, margins, cash-flow generation, balance sheet leverage, up to the mark with the best of them?

04

Is our **governance** state-of-the-art, are the right people in the right positions, and are we paying them market rates? Finally, are we on top of the rapidly evolving debate regarding climate and societal change?

Comparing these questions with the statistics regarding activists' entry points, we can see that a comprehensive strategic defence plan contains arguments that can be deployed against all lines of attack. Thus, any company that has made the effort of putting a strategic defence plan in place has gone a long way towards creating a rampart against activists.

However, while a defence plan against strategic buyers provides a framework and forces a company to define a clear stand-alone

value proposition, there are limitations to applying a straight M&A approach to a case of shareholder activism.

Strategic takeovers essentially are about financial performance, whereas activist campaigns are much broader in nature, taking in governance, board composition, issues of entrenchment and, increasingly, ESG considerations. So, while M&A defence preparation is undoubtedly a help, many gaps remain. A fully-fledged activist defence plan has to go further.

To upgrade a strategic defence plan against an activist campaign, the following contingencies need to be addressed:

01

Criticism of the board and corporate governance, which can be a much greater point of contention – and more personal – in an activist battle, than in an M&A situation.

02

Strategic and financial challenges beyond calling for (or opposing) M&A, such as returning cash to shareholders or other capital structure changes.

03

Shareholder activist siege, successful or unsuccessful, which can last much longer than any straightforward M&A transaction. In recent years, activists have shown great persistence, as demonstrated in the campaigns mounted in Germany by Elliott Management against McKesson/Celesio and Vodafone/Kabel Deutschland, both of which took years to be resolved. In the US, activists routinely put relentless pressure on companies behind the scenes for months before going public with protracted battles.

04

Activists' ability to act fast, and outside of regulatory frameworks such as the UK Takeover Code. This makes their behaviour less predictable and difficult to address.

05

Activists' freedom to select peers. Activists may choose peers to substantiate their criticisms which were not part of the market debate before.

06

Multiple shareholder-lobbying tactics based on varying investment objectives. While in an M&A situation the desired outcome for the attacker is obvious, this may not be the case for activists who sometimes have a moving target on value extraction, starting with one easy entry point but then expanding into others as the market debate evolves and intensifies.

07

Different financial levers. A frequent driver behind hostile bids by strategic buyers is synergies. In contrast, activists are more likely to criticize an elevated cost base, or sub-par growth.

08

Activists' relationship with institutional shareholders. As lines between activists, hedge funds, active long-onlys and passive index funds become blurred, it stands to reason that mindsets among all types of investors become more similar, and their reasoning more aligned, than with strategic buyers.

Where do we go from here?

Discussions about activism in Europe in recent years suggest companies need to face this challenge head-on and be ready, essentially by becoming their own internal activist.

When an activist launches into action, behind the scenes or publicly, they will have prepared their campaigns for months. Companies must also plan their defences well in advance or they will be caught at a disadvantage.

But even companies that have a comprehensive, up-to-date strategic defence plan prepared, and who therefore think they are safe, have not done all the homework they need to do in order to mount an effective activist defence. There are too many differences between the two approaches for a one-size-fits-all response.

About Kekst CNC

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