Developments in shareholder activism

Corporate analysis: The 2017 Lex Mundi Global Seminar on Cross-Border Transactions was held on 2 November 2017 in London, United Kingdom. The seminar brought together legal practitioners, financial institutions and advisers, commentators and market participants in the cross-border M&A sphere to discuss key trends and developments in cross-border transactions. This article summarises the discussions and conclusions in relation to global developments in shareholder activism, the subject matter of the of the fifth session of the conference.

Increase in activism across Europe

Shareholder activism has increased in Europe significantly over the last five years. Although Europe is still behind the US in terms of activism — in 2016, there were 319 recorded incidences of activism in the US, compared with only 75 in Europe and the figures are similar for 2017— momentum of activism is increasing across Europe. Every year there are seven or eight headline cases across Europe. Interestingly, the UK has not seen a vast amount of activism: 15 out of 75 instances of activism have focused on targets in the UK. The UK is a mature country in terms of corporate governance, which may go some way to explaining why only 20% of activism is in relation to UK companies.

Company size and industry plays no role in being a target

The size and industry in which companies operate do not impact on whether or not they are likely targets for activism. PE funds are looking to increase assets under management, and it is easier to target large companies.

The causes of the rise in activism

Reasons for the rise in activism across Europe include:

- there has been a shift in the shareholder base from family to institutionalised money: companies are making money for pensions and insurance companies – this shift happened earlier in the US
- funds have diversified their holdings – not only in terms of industry but also by jurisdiction/region and are targeting large companies where there is significant value to realise (eg, US hedge fund, Elliott Management)
- shareholders appreciate that activists make demands that have substance — shareholders have become more receptive to (and are willing to support) activists
- in the majority of cases, shareholder activism has led to an increase in the value of a company
- shareholders have lost patience with management treating companies like their own fiefdom
- transactions specific activism, eg, activism around squeeze outs and domination agreements

Activists have pursued different agendas, usually with the ultimate aim of increasing company values. Long investors — who do not necessarily have the time, resources or expertise — have been unable to engage actively in pursuing reforms required to increase company value, whereas activists can act as catalysts for change and are able to garner the required shareholder support. In addition from pressure on management from activists, there is political pressure from governments in relation to 'say on pay' and pay ratios of CEOs and upper management.

Activists have also become more sophisticated in their engagements with company management and are willing to spend time and money in assessing whether possible target companies are underperforming. Some activists have approached former employees, former directors and stakeholders in companies as part of this assessment process.

Company reactions to the increase in activism

With the increase in activism, it is common in Europe for large companies to carry out their own assessments of whether they are likely targets of activism (or employ specialist management consultants) to make such assessment. Part of this process includes examining:

- total shareholder return over three to five years
- margins and growth profile of the company compared with those of peers in the same industry

Strategic management consultants will have networks in place enabling them to connect industry experts with former mid and senior level management to provide perspective and insight on a company and its culture.

Settlement

The majority of activism takes place out of the public arena, highlighted by the fact that in 70% of cases, some form of settlement between the activist and management is reached, whether that is an activist taking a position on the board, otherwise implementing board changes or the board takes any other necessary action to address the concerns of the activist, eg the sale of a business division.

In most cases, activists do not want to be appointed to the board. However, in transactions involving distressed/special situations investment opportunities, it is more typical to see activists join the target board.

Activist perspectives

To launch a successful 'attack', it is important that:

- the target company's valuation shows it has been misvalued or is underperforming
- it is possible to remedy the misevaluation / underperformance
- there is an open shareholder structure (so that activists know who to approach for support of any proposed steps)

Types of activism and how targets are responding

Types of activism

Broadly, there are three different types of activism:

- traditional activism — often incited by failings in corporate governance / mismanagement or entrenched management
- bumpitrage — where funds seek to achieve a price increase in takeovers / mergers by increasing their stakeholding and galvanising other shareholder support for the uplift
- activist takes on the role of a merchant banker, wants a seat at the board and to be the agent of change

Target reactions to activism

The reaction to activism a decade ago was very defensive: companies always thought that activists were 'bad'. This prior approach was counterproductive and emboldened activists in their actions towards relevant targets. Boards now take a very different approach and are willing to listen to activists.

Boards should:

- listen to the concerns raised by activists, take comments on board, undertake an analysis — good corporate governance is essential
- ensure that relationships with institutional shareholders are maintained and that there is a dialogue / sufficient level of communication
- assess why the board is the right board for the company and consider the issue of diversity within the board
- consider how capital is being deployed: how much goes to share buybacks, M&A, cap ex, etc
- take action to appease activists (where demands are reasonable) prior to the activist launching a public campaign
- regularly evaluate the company's performance and value — the board should have its own views on valuation and what level shares in the company should be trading at and take steps if the reality falls short of expectations (eg, sell/spin off divisions to improve margins, improve efficiencies where viable)
- ensure that any company announcements or press releases are not hostile towards activists — the directors should conduct themselves in an irreproachable manner

Most companies can avoid activism in the first place by taking pre-emptive steps, such as engaging with / obtaining feedback from shareholders and taking into account shareholder views when making board decisions (ie, by being proactive).