Proskauer

Take Action!

What Directors and Senior Executives Need to Know on Shareholder Activism

April 9, 2019

The growing issue of shareholder activism continues to make global headlines as activist investors target new companies, and new geographies.

This article outlines some of the key considerations for directors and senior executives seeking to mitigate the risks of shareholder activism.

Activist campaigns are now launched in a broad range of sectors, on an array of issues, and it appears that no company is seen as too large to avoid attacks.

Once regarded as opportunistic 'corporate raiders' with a short-term focus on returns, today's activists are increasingly welcomed by institutional investors who view them as voicing legitimate concerns or pointing out hidden value opportunities.

The activist landscape

Activists, particularly those based in the US, have historically been known for their aggressive tactics, including public campaigns aimed at forcing company management to adopt certain changes. However, activists have been able to successfully rebrand themselves as positive influences on shareholder value, eschewing hostile tactics in favour of more discreet and collaborative measures. In the UK, shareholder activism is often less adversarial and activist investors typically approach a company's senior figures directly, putting forth suggestions and engaging in constructive conversations with management in the hope of reaching a negotiated consensus.

In an era where institutional investors are under greater pressure to deliver returns, there is a willingness to support activist initiatives that aim to increase shareholder value and governance standards. There are several factors that have contributed to this growing support for activism in the UK, including regulations promoting stronger corporate governance and giving greater access to investor information.

Objectives of activists

The aims of activist investors are broad, however, the primary goal is usually to bring about one or more of the following forms of change:

- changes to governance practices or the composition of the board/senior management;
- seeking control of the board to alter management policy or the strategic direction of a company;
- special interest activism on corporate social responsibility issues, such as environmental practices; and
- measures aimed at unlocking value for shareholders, such as the return of capital and unreserved cash to shareholders, spin off of non core activities or seeking merger of the whole business.

Defence against activist attacks; dos and don'ts

In this new era of increased activist campaigns, what should target companies do to address this risk?

DO

- *Execute the defence plan before there is a need to do so*

Activists are adept at spotting ways to increase shareholder value. By far the best approach, if there is a clear action that can be taken which will improve value, is to proactively take that action before an activist spots the opportunity.

- *Prepare*

To ensure board preparedness, directors and senior management will have to be cognisant with current shareholder dialogue, key themes of activist attack and the commercial drivers for potential activism. From an internal perspective, this will require regular board updates on issues such as investor sentiment, as well as operational matters.

- *Control the conversation*

It should be the responsibility of the directors to ensure that a company's strategic vision is clearly articulated along with explanations as to how this will maximise long-term value for shareholders. It is important for management to put forward a strong investment thesis that provides adequate justifications for the company's strategic and financial decisions and doing so publicly can reassure the investor base and the wider market.

- *Perform regular risk assessments*

It is of critical importance that companies perform periodic risk assessments, analysing their market and business lines from the perspective of an activist. Directors and senior management should be aware of a company's vulnerabilities and seek to address issues that could attract activist attention.

- *Review corporate governance*

Companies should undertake regular reviews of their governance framework and compensation structure, maintaining high corporate governance standards, including compliance with all regulatory requirements as well as best practice policies, such as the UK Corporate Governance Code.

- *Monitor activity*

Companies should continually monitor shareholder behaviour (such as unusual voting patterns) and changes in the composition of their investor base. Companies should also assess the wider market, taking note of peers that have been subject to activist campaigns and the proposals that are typically put forward by activists within that sector.

- *Establish a response team*

Assembling a team that can form a response strategy, manage relationships with stakeholders and gather intelligence on behalf of the company can prove critical to surviving an activist attack. In addition to internal personnel, this will include external advisers that are well acquainted with management, familiar with the business of the company and, most importantly, lined up in advance.

- *Communicate with stakeholders*

It is important that management, as a matter of good corporate governance, engages with investors on a continual basis to gain a greater understanding of shareholder concerns. Companies should create a tailored programme of engagement, timetabling opportunities to engage with shareholders outside of general meetings.

DON’T

- *Stonewall or rely on generic responses*

Companies are encouraged to engage in constructive dialogue with activists, particularly bearing in mind the potential for activists to escalate private discussions to public campaigns.

- *Be quick to characterise activists as hostile agitators or reject activist proposals*

Given the currently receptive sentiment towards activists within the investment community and the general public, immediately attacking activists could eventually lead to embarrassing climb downs.

- *Be reactive*

Defence strategies should be discussed regularly by management and the board rather than being prepared only in response to a specific activist attack.

The future for target companies

Shareholder activism is on the rise globally and the signs suggest that this trend will continue for the foreseeable future. In the US, the success enjoyed by activist funds has seen capital flood into them, with a knock on consequence leading those funds to target a myriad of mid market and smaller cap companies as well as large and well known corporates. The next logical progression of that trend will see similarly highly capitalised activist funds consider mid market and smaller cap companies in other jurisdictions; creating a spreading influence on corporate behaviour at all levels, and across jurisdictions. In a climate where activists are seen as potential agitators for positive investor returns it is imperative that company directors and senior management of companies of all sizes prepare for activist interventions and adjust their response strategies accordingly. Companies should take a proactive stance in managing activist risks and seek to adopt some of the defensive measures outlined.

Related Professionals

- **Andrew Wingfield**

  Partner

- **Rob Day**

  Partner