

# Shareholder Activism: A Survival Plan

Market disruption and weakened business performance create the perfect conditions for increased shareholder activism. **Malcolm McKenzie** and **Paul Kinrade**, of Alvarez & Marsal, talk to Criticaleye's **Emma Riddell** about how to keep the activists at bay





**R**io Tinto, Rolls-Royce and The London Stock Exchange are some of the big names that have recently hit the headlines due to shareholder activism.

“If you look at the amount of US activist funds that are investing in Europe, it is around 6 times higher than last year,” explains **Malcolm McKenzie**, Head of European Corporate Transformation Services at Alvarez & Marsal (A&M). “At first it was largely in the UK, but there’s also increasing activity in Germany, Switzerland, Italy and Benelux. So, it’s growing in terms of numbers, size and geography.”

### What Makes a Company a Likely Target?

A country’s corporate governance and company law will determine the ability of activists to use their equity stake in a company to exert change. So, the UK – where it is relatively easy to call an EGM or force a vote on directors – is more attractive than the US or Germany, for example.

But what marks a particular company out as a target? “Activists are looking for good companies that could be great, or

*“The board or executive may not be maximising the performance potential in the current environment”*

perhaps they were great and have slipped back. They are not looking for basket cases,” **Malcolm** says.

Specifically, activists are looking for companies where the share price is below its potential, so there is value to be released. **Malcolm** cites two common reasons for this: “Firstly, the board or executive may not be maximising the performance potential in the current environment. Or secondly, they may not be getting their message across clearly,

and therefore the market undervalues the business. It’s normally a combination of both of these.”

### The Nature of Activist Activity

Activists tend to fall into two categories: those involved operationally for longer-term performance improvement, like ValueAct and Cevian, or those responding to an event-driven situation, such as when using ‘bumptrage’ within an M&A situation. This occurs when activists see a company, or division, for sale at what they assess is an insufficient amount. They then take a stake in the target and argue for a better price from the buyer, thereby securing a quick return.

To present their argument to a company, and get other investors on board, activists will pull together information on the business’ performance and, in many cases, a particular individual’s role within it, such as the CEO.

Activists will then achieve their aims via a variety of means, including:

- negotiations with board members (often “under the radar” and ideally collaborative) >





- forcing shareholder resolutions (including those triggering changes to the board)
- publicity campaigns (however, most interventions occur behind the scenes and never hit the headlines).

**Paul Kinrade**, Managing Director UK at A&M, says: “Activists will try and avoid the public fight if they can, as it becomes very painful and a distraction for the business and management.

“If there are board changes, you may simply notice that the chief exec has moved on for ‘new challenges’ and an appropriate new chief executive has come along. And perhaps a new non-exec director may appear who happens to be a nominee from one of the more activist investors,” he says.

Such leadership changes are a common activist aim, indeed 69 percent of all situations involve a request for a change to the board. “Typically, this is one of the more palatable approaches for an activist, who can say they are looking for greater representation to make sure major shareholders are having their views heard,” **Paul** says.

### The Way of the Wolf Pack

In most situations activists will seek to get a ‘wolf pack’ of fellow shareholders together. This can take a variety of formats, such as when the pack are baying together, or there is a lead wolf making all the demands (who may, or may not, be discretely representing the interests of other investors).

When the activists’ aim is to get someone new onto the board it can be reasonably easy to pull the right wolf

“Activists will try and avoid the public fight if they can”

pack together. However, **Paul** says it’s a far tougher proposition to gain the support to oust a board member and bring in someone new. “The onus becomes more about demonstrating what it is about the person you’re seeking to change, why are they specifically not helping maximise the value in the business?” he explains.

The activist will need to build a strong, evidence-based case on an individual’s “value-detracting activity”.

### How to Avoid Activists

Activists only strike because a company is judged to not be realising its value. So, the best defence is to run your business well, and to communicate this clearly to the market.

**HOW TO AVOID THE WOLVES**

- Run your business well
- Communicate your story to the market
- Embrace challenge and avoid groupthink
- Scan for disruption and be flexible
- Learn from activist campaigns

In terms of addressing performance, **Malcolm** recommends performing an ‘outside-in’ analysis of your organisation. This entails asking challenging questions, such as:

- What would an activist do differently?
- What would a private equity owner do if they owned the business?
- What are the sacred cows that are not being addressed?
- Where are you not pushing hard enough or executing properly?

There needs to be diversity of thinking at the top level. “Bring in challenge, rigour, new focus and new ideas to make sure you’re shaking up the board in the right way, because that’s what an activist is going to do,” says **Paul**.

Different backgrounds and areas of expertise will help a business detect and respond to market disruption, which is often a trigger for activists.

“How does the company react to this disruption?” he asks. “If they don’t react well that will become clear in their numbers very quickly, and they will become identified as a target. So, it’s very important that companies remain nimble, flexible and alert.”

It’s vital to think about a robust, well-coordinated communication strategy, although **Malcolm** cautions against relying on one spokesperson. For example, he recommends inviting NEDs to sit in on broker meetings and meet investors.

It is also important that events like these aren’t so stage managed that you don’t hear what people are saying around the edges. “Not only the >



chairman, but the senior independent director and non-execs, should ensure they have their own appropriate communication channels into the investor base,” he advises.

**Paul** characterises communication as a “hearts and minds operation” which pitches the board against the activists.

“If the board doesn’t have the right relationships, the depth of understanding, the contacts to ensure that institutional investors are happy, then there’s a rich ground for activists to come and win the hearts and minds of those investors. You can’t allow a disconnect to occur.”

## Be Prepared to Fight Back

It is crucial that you engage with activists if they do target your business. If you don’t it normally gets worse, **Malcolm** warns.

After all, they may have something valuable to say, which you as a board or management team have missed. However, you also have to be ready to defend your position as activists aren’t always right in their assumptions – they won’t have all of the inside information about the business, and they may be viewing performance over a shorter timescale than the board.

**Malcolm** also advises looking at the size of the shareholding, as you don’t want to be monopolised by someone who owns 3% of your stock.

“It can be a challenge, during an activist campaign, to make sure you’re representing the broader interests of the shareholders and not just the more vocal guys.”

## In Summary

The underlying theme is that activists target relative weakness, such as a high cost base, insufficient margin, an overly diverse portfolio or poor staff capabilities. As a board or senior leadership team of a public company, you should be addressing these problems rather than allowing others to use them as a platform for hijacking your business.

“We see quite a lot of businesses in the middle or bottom half of the listed market where the board, to be frank, is not seen as doing its job properly,” **Malcolm** comments. “It needs shaking up, as shareholders have been losing out on value. So, activism is a catalyst for change.”

After all, interventions can result in positive results, certainly for shareholders. “If a major activist becomes public on a stock, classically, there will be a 5-6 percent share price bounce simply on the back of that. Whether or not that is sustained depends on whether any real change is driven in the business,” says **Paul**.

It comes with the territory when you’re a Plc. “Everyone is desperate for yield,” adds **Paul**. “So, if an activist can go to an institutional investor and tell a coherent story about how they can drive some real yield in a particular stock, then that investor is going to listen.

“You want to make sure you have predicted that, dealt with it, made sure investors understand the story, where you’re going, the ambition, so that you’re inoculated against that activist attack.” ■

Access Alvarez & Marsal’s latest Activism Alert, and understand the risk factors your business is exposed to, by [clicking here](#)

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Paul brings more than 25 years of experience in performance improvement and operational restructuring. He has worked in numerous countries throughout Europe, the Americas, South East Asia and the Middle East.

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