



Facing the threat of activist shareholders

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Life as a Board level executive of a quoted company could never be described as easy but in times like these many Boards are starting to feel a little edgy.

In times past it seemed as if senior executives could just get on with running the business as they saw fit and only occasionally had to worry about dealing with shareholders. Of course this was never entirely the case, but with the advent of activist shareholders asserting their ownership rights, boardroom life started to become uncomfortable.

After Brian Myerson's Active Value set the tone, modern shareholder activism in the UK arguably came back into fashion with Hermes, The Hermes Principles and the Focus Funds approach. As a result of the work done by campaigning fund managers like Alastair Ross Goobey, the UK's corporate governance standards are some of the most progressive in the world. It is now common for shareholders to take a keen interest in corporate strategy and governance, and size is no barrier to becoming the object of an activist's attention.

Having worked in a great many activist situations (both in defence and attack) it is surprising how companies fail to prepare for the possibility of an activist approach. It seems elementary that a company's management would evaluate its performance or a strategy and be prepared to defend any weaknesses. But time and again Boards are ill-prepared to communicate, regardless of whether they use their incumbent advisers or opt for heavy-hitting specialists.

Activist approaches are not going to diminish any time soon. But the good news is that the warning signs are there for all to see such as a new entrant to the shareholder register or a simple phone call to management from an existing holder. Boards that fail to seriously engage at this initial point lose a lot of ground. Frustrated investors are no longer afraid to use the media and do so with increasing skill. To a degree the fact that an activist approach becomes public knowledge at all suggests a failure on the part of a Board to keep up a constructive dialogue.

Broadly speaking companies can expect to be a target in a number of scenarios. Boards that are unwilling to evaluate strategic alternatives (especially where operational performance lags the peer group) are the most obvious candidates. But companies with a lot of idle cash on the books where the Board is unwilling to look at M&A or other opportunities also attract attention. Another major class are those turnaround situations which are failing to generate sustainable returns; not forgetting the investor hot-button of excessive remuneration and/or payment for failure.

Activists don't want to take over the running of a company themselves. Instead they seek to install a framework where managers can achieve better things on their own. Come the EGM they usually attempt to make changes to require greater shareholder consultation on big decisions; return cash to shareholders; or install new Directors who share the activist's views.

In dealing with activists we have found that the following approach often yields good results:

- Understand the true feelings of your shareholders by using perception studies and feedback sessions to ensure the company knows what its owners think. As an activist campaign develops it is vital to maintain this understanding.
- Understand from the company's broker what demand is like for the shares so that buyers can quickly be found for the activist's holding when/if it decides to sell up.
- Spend time educating shareholders on the business and its strategy, focusing on long-term value or, in the case of high yielding stocks, income return.
- Be prepared to act and react in a variety of scenarios according to a solid strategy. Do not give emotional or hostile quotes to the media.
- Don't avoid talking to activists and expect them to fade away: engage in dialogue and if necessary be prepared for a PR campaign.
- Don't let management lose credibility with the City by taking a wholly reactive stance which answers the public statements of dissident shareholders.
- Don't announce an incomplete short-term strategy. It should be tested and hold up well to scrutiny. Tell investors how problems are assessed and, more importantly, how they will be resolved.
- Spend time understanding what likely support levels will be for activist proposals and how to win the argument with a greater number of shareholders.
- Relationships with major shareholders are important. Do not let activists influence larger owners without having heard the company's side of the story.
- Use proxy solicitation firms like Georgeson to get the company's supporters to vote proactively when EGM resolutions come to be scrutinised.

Much of this is common sense and many of the points above would be part of an ongoing programme of top drawer investor relations. But regardless of the type of activist a Board faces the most important thing a PR adviser can do is galvanize the client to understand the gravity of the situation and to take all activist approaches seriously. Ultimately shareholders own the business and the Board is merely its steward. It is a costly mistake to believe otherwise.

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