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TALKING POINT

Preparing for European activist storm

Activist investors are having a profound impact on corporate America. Approximately $60 billion is now dedicated to activist strategies, according to Hedge Fund Research.

Major corporations from Hess to Procter and Gamble, from Yahoo to Hewlett Packard have been directly affected. So far this year, more than half of the proxy fights that resulted in a public contest for board seats resulted in the dissident obtaining board representation. Analysis of 13D filings in the US shows levels of activist intervention increasing over the years since the financial crisis.

Until recently, however, activism has been relatively rare in Europe. Given the global nature of financial markets, this is perhaps surprising.

According to data from proxy voting and corporate governance group ISS, only 18 disputes were put to a shareholder vote in Europe last year – a 28% decline on the previous year. Fifteen hedge funds that pursued activist strategies in Europe have been wound down since 2008 and the assets available to these strategies have halved over that period.

Historically, both in the UK and in continental Europe, shareholders have made their views known in private or, more often, have voted with their feet by selling stock rather than engaging with the management.

Even the much-vaunted Shareholder Spring of 2012 saw more pressure for changes in remuneration practices and management behind the scenes than was evident in public. The immediate shareholder pressure seems to have subsided as corporations have anticipated and addressed investor push-back and corporate performance in many sectors shows improvement.

But this may represent just a respite, and the pressure on remuneration committees and concerted investor resistance to pay and bonuses could well restart in earnest as the economic recovery strengthens.

Despite the important legal and regulatory differences between the US and Europe, the US can offer valuable lessons in how activists have worked and corporations have responded.

One aspect of the issue, common to both the US and Europe, is the importance of understanding the changing activist landscape and how a company's current strengths and weaknesses would be perceived – and acted on – by an activist. By doing this, a company and its board will be prepared to act quickly should an initial threat become a public showdown.

In many cases, US activist investors come prepared with a detailed analysis of their target's businesses and management team, ready to take their proposals to shareholders and, crucially, the voting advisory services.

In such cases, substantive engagement by corporations on the issues, rather than the mobilisation of hostile takeover defence tactics, has often proved to be the best strategy. Communication and winning the soft, as well as the hard, substantive arguments are key.

Having a strong investor relations function and good bridges to the investor community often prove to be invaluable, both in avoiding negative attention and maintaining shareholder support.

In the US, activists have enormous credibility with the traditional investor community. Their ultimate ability to change the board if their requests are not taken seriously has been established for some time.

Voting advisory organisations, such as ISS, are vociferous and willing to take a stance that is not supportive of management and, therefore, can be enlisted to support activist causes.

European corporations do start with some advantages. Many jurisdictions have share disclosure obligations that make it harder to build a substantial stake covertly, and large privately held or privately controlled corporations – more prevalent in Europe than the US – will reduce the number of possible targets.

Much activism in the US relies on the ability to cause a transaction to occur, so-called event activism. This will often turn on the strength of the mergers and acquisitions and financing markets, which have been generally depressed for some time, but are expected to pick up.

Historically, there has been evidence that suggests investment returns from activism in Europe have been lower than in the US, but it is not clear that, in rapidly changing markets, this will continue.

European investors might find the reported $520 million profit made by Daniel Loeb for shaking up Yahoo a tempting case study.

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