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Interview with Harald Selzner
Partner, Latham & Watkins

Activism spreads to Europe

Shareholder activism is an ever-present challenge to corporations in the US. Now, the trend has spread to Europe and, even though the process can be markedly different, forward-thinking companies would do well to start planning

Inspired by the success of shareholder activism in the US, a pattern is emerging in Europe, as hedge fund activists make the best of a difficult situation by setting their sights on struggling corporations.

The rise of shareholder activism in Europe means that companies, no matter their size, can ill-afford to overlook the strategies employed by these groups, and experience shows that it pays to be mindful of their methods. Alliance Trust, Cevian and Nexans – these and others have come up against activist campaigns, and for as long as European markets struggle to recover, activists will be on the lookout for easy opportunities.

European CEO spoke to Harald Selzner, a partner in the corporate department of the Düsseldorf office of Latham & Watkins, and co-chair of the firm's global M&A practice, about the rise of shareholder activism and how companies in Europe can prepare for the challenge.

Visitors from America

According to Selzner, activist hedge funds have enjoyed a significant increase in capital inflows over recent months, and their strategies have largely outperformed those employed by more traditional funds. "The increased focus on Europe is driven by a perceived undervaluation of certain companies by the capital markets, such as discount to balance sheet valuation, and companies with a large free-float, as well as existing issues with corporate governance and large cash reserves."

In addition, shareholders in Europe are less tolerant of underperforming companies, as the financial and euro crisis continue to slow and opinions shift more towards activist campaigns. "Institutional investors are more and more prepared to cooperate with and support activists in their negotiations with boards, and proxy advisors are gaining importance, easing the alignment of shareholders' opinions", Selzner added.

Speaking on the differences between US and European activists, Selzner noted: "I think it is helpful to understand if they are home-grown European shareholder activists, or if they are US shareholder activists looking for opportunities in Europe. Although there are significant home-grown European activist investments, the majority of the relevant market participants are still US hedge funds. These US funds are required to adjust their strategies as they face a variety of European cultural peculiarities and regulatory regimes with special corporate governance features."

Tactical nuances

As has been the case in the US, activist tactics in Europe range from friendly to hostile. However, Selzner notes that activists in Europe have taken a more cooperative approach due to differing characteristics in the legal and business framework. Historically speaking, this framework amounts to a less confrontational tone in business communications and management approach from institutional shareholders, greater union powers, mandatory co-determination requirements, and a requirement for actions to focus on all stakeholders, not just shareholders.

"In general, activist hedge funds in Europe, more often than in the US, refrain from public campaigns against the management. As a consequence, many activist investments remain unnoticed by the public – to the extent that the activist's participation in the target company stays below the relevant mandatory notification thresholds."

Unlike in Europe, activist hedge funds in the US are not restricted to certain industries, but employ a multi-industry focus. Selzner added to this: "The criteria used by activist hedge funds in Europe for screening potential targets are basically the same criteria activists apply in targeting US companies. Potential targets can be characterised by poor stock price performance compared to industry peers, high cash reserves, business lines that can be sold or spun off, a receptive shareholder base, and existing corporate governance concerns."

Speaking again on the strategies most often employed by activists, Selzner observed that they "typically aim to change the target's strategy (i.e. to exit from or enter into markets or business segments); dividend policies, including share buy-back programmes and distribution of super dividends; board composition; or (initially) block tender offers to increase the offer price. In addition, activists focus on balance sheet optimisations, as well as operational and corporate governance efficiency campaigns."

What should executives do?

An influx of shareholder activists asks that companies take certain precautions and adopt certain principles to protect against any potential damage. Clearly, there's a great deal to be said for those who analyse their business from the perspective of an activist, which means constantly reviewing the business strategy and identifying weaknesses early. "In general, boards need to become proactive about unlocking shareholder value. Due to the increasing level of support from institutional investors for activist campaigns, an ongoing proactive and transparent communication with existing shareholders, institutional investors, and proxy advisors is key, as is explaining the company's strategy in a clear, understandable way."

Another important consideration is that activist investors are no longer intimidated by larger companies and, according to Selzner, a big market capitalisation is no longer an effective defence against activist engagements.

"Once addressed by an activist shareholder, it is crucial for the targeted company to understand that different activists have different strategies, campaign styles, and demands. The relevant board needs to develop a tailor-made response strategy, depending on the individual activist involved, exhausting all available sources of information. The management needs to view activism as a multilateral (communications) challenge, rather than a mere bilateral (defence) phenomenon. A constructive dialogue may minimise the risk of a long-running public campaign, and boards should not dismiss activists' ideas out of hand."

Boarding up the board

Executives and directors should be particularly mindful of the risks posed by activist investors, with many having infiltrated the boardroom in years past. "Globally, their success rate has increased dramatically during the past few years, and that success has been evidenced both by fights won and by favourable settlements implementing board change. While no company wishes to have activists forced onto its board, planning for that possibility in the long run is useful, both for the board and for the company's shareholders", said Selzner.

"The important thing to bear in mind is that it is best to implement these measures on a clear day. In the context of a proxy fight, or even settlement discussions with an activist, changes to bylaws, committee structure, board qualifications, confidentiality agreements and the like, while appropriate, may often garner more judicial or other unwelcome attention. Instead, spending time at your next board meeting to both review these matters and make bylaws or other policy changes is appropriate, and will generally serve a board well in its ability to maintain culture and effectiveness in the boardroom if activists do come on the board."

Whereas activist directors tend to have a more hands-on approach in the boardroom, there are ways that boards and management can adapt themselves to suit this model. "The issue of the relationship between boards and management is critical, no matter who is on the board", noted Selzner. "There is a line that needs to be drawn, because the board is not there to micromanage operations. It is important to have a strong CEO, because a strong CEO will manage the line-crossing that can go on." ■