

Formulating your company's strategic response to the activist environment

Activist investors aren't a new phenomenon—but recently, the combination of a favorable regulatory environment and an abundance of funds to invest means they've become a force to be reckoned with, and now they're here to stay. In fact, by the end of Q3 2018, activists had almost \$300 billion USD of funds deployed in their targets.

One key consequence is an important spotlight on board activities. Every major business decision, ranging from business strategy and operational performance to capital investment and M&A, is increasingly subject to external scrutiny, often involving a wide range of stakeholders.

In response, CEOs and boards may wish to think and act more like activists so they can prevent public, and often costly, showdowns. That means they might want to consider the motivations of activists, ask (and answer) some difficult internal questions about company performance and future direction, and then take concrete steps to improve shareholder returns.

In this pamphlet, we'll show you how boards can learn from the "activist mindset" to pinpoint opportunities for action—and how Deloitte can help boards with their self-assessments to support their value-creation activities.

These pre-emptive actions can assist management in demonstrating that they are listening to shareholders and taking measures to achieve superior results. They can also lead to mid- and long-term strategies that help a company form a more convincing version of itself.



Nearly
\$300B USD
of activist investor funds deployed
(as at October 2018)

Contact us:

Jason Caulfield
Global Head
Value Creation Services
+44 20 7303 4883
jcaulfield@deloitte.co.uk

Michael van der Boom
Head of VCS Switzerland
+41 58 279 7653
mvanderboom@deloitte.ch

Andreas Warner
Head of VCS,
Europe/Middle East/Africa
+49 89 29036 8022
anwarner@deloitte.co.uk

Peter Callas
Partner, VCS UK
+44 20 7303 8748
pcallas@deloitte.co.uk

Rob Arvai
VCS Co-Lead, Asia Pacific
+61 2 9322 5995
rarvai@deloitte.com.au

Yoshihiro Madea
VCS Co-Lead, Asia Pacific
+81 80 3411 8574
yoshihiro.maeda@tohmatsumatsu.co.jp

Heather Blumberg
Head of VCS Canada
+1 416 601 5930
hblumberg@deloitte.ca

Larry Hitchcock
DC Principal, Consulting
Mergers & Acquisitions
+1 312 486 2202
lhitchcock@deloitte.com

Deloitte.

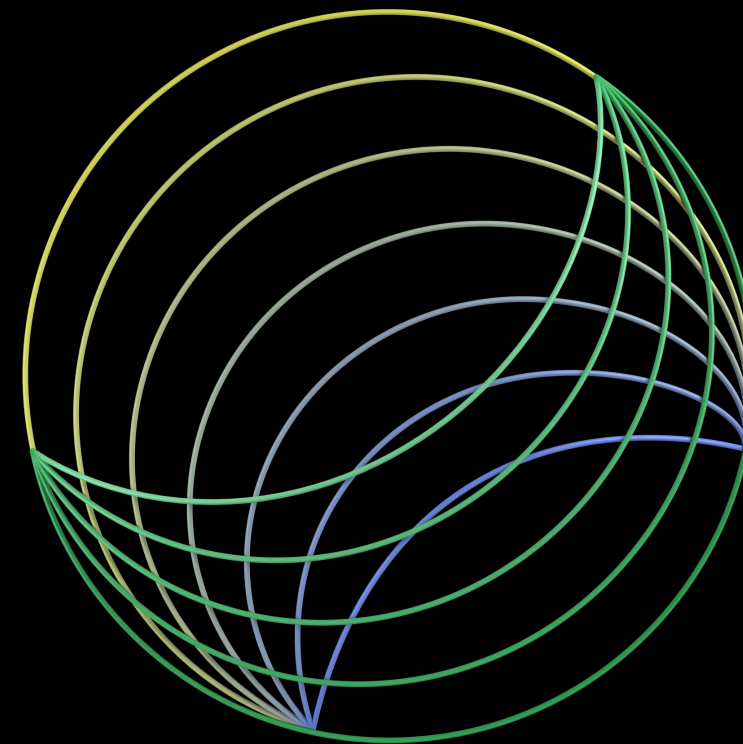
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"Be your own activist":

How boards can develop an activist mindset to drive secure value

Understanding the activist mindset

While activists may pursue a range of strategies and tactics, their approaches are often based on a common set of beliefs. As part of the journey to “becoming your own activist,” boards must first understand the views that motivate activists.

In our work to define the activist mindset, we’ve distilled some of the prevalent views that may tie together activist approaches. These include:

- **Sooner is better than later:** Making proactive change now rather than delaying tough decisions or waiting for the future to unfold
- **Rewards of real challenge outweigh the risks:** Driving dramatic change in strategy is comparatively high risk and low return for board members; the risk is not the same for activists
- **Margin over revenues:** Management can suffer from a “bigger is better” bias—sometimes at the expense of profitability and margin
- **Be open to outside perspectives:** Energy is best spent on transformation, not battling to prevent outside influence
- **Facts don’t lie:** Activists are much less likely to be swayed by interpretations and narrative, instead focusing on “the cold hard facts” that show the true economics of a business and ensure the financial transparency to see them
- **Straightforward can be best:** The highest rewards can sometimes be obtained by basic and tactical interventions, instead of complex, higher-order strategies
- **Target efforts effectively:** While boards may focus at business-unit level, the most effective solutions may reside at the sub-division level—and efforts at the ‘wrong’ level can erode significant shareholder value



Almost **3x growth** in activist investor funds deployed from 2012 to Q3 2018



Over **70% of activist demands** acceded to (in whole or part) for large activists from 2014 to Q3 2018

How to be your own activist—and how Deloitte can help

One of the most significant strengths activists have is that, coming from outside a company, they are unencumbered by inertia, vested interests, and emotional attachments.

Companies might want to consider looking at themselves in a similarly detached way, to spot weaknesses and unexploited opportunities, and root out inefficiencies that can detract from shareholder value.

Deloitte can help companies carry out **self-assessments** to support their value creation opportunities, divestments, and “disruptive” M&A, which targets small, fast-growing businesses and technologies to capture innovation-led growth. We’ve identified **nine key areas** a board should consider.



1. Shareholder returns

Relative weakness compared to peers and benchmarks for the sector makes it essential for the management team to understand what’s driving underperformance.



2. Capital structure

Management should ensure that capital structures, and the nature and levels of debt, don’t provide openings for undue activist influence.



3. Commercial positioning

Challenging the company’s commercial direction and performance, meaning validation of the underlying assumptions powering a strategy is crucial.



6. End-to-end operational potential

When big changes—such as transformational IT projects—are stymied, and a company’s assets or people are ineffectually utilized, shareholders may look for other perspectives about how to make the most of their invested capital.



7. Cash focus

The choices management makes in addressing any surplus cash can influence how and whether an activist campaign gains a foothold.



4. “Less than the sum of its parts?”

When the synergies between business units and divisions are not apparent, the company should challenge the value-add of expensive central corporate management structures and functions.



5. Business unit performance

Management should routinely examine underperforming business units and look to either improve performance or divest those business units.



8. Value creation plan, communication, and delivery

A coherent and comprehensive value creation plan can provide a logical, fact-based perspective on where to look and what to do, as well as the financial benefits and practical steps required.



9. Board composition and governance

A regular, integrated board assessment is a helpful way to identify challenges in oversight, capabilities, and structure related to the governance regime in which the company operates.

“If you were to assess the business from the outside looking in, what should ‘good’ look like? Leadership should use this unconstrained approach to challenge their thinking.”

—Michael van der Boom, Value Creation Services, Deloitte Zurich