Shareholder Activism

Board Members: Are You Thinking Like an Activist Investor?

By Chris Ruggeri and Justin Silber

The growing drumbeat of investor activism isn't just a trend; it's a fundamental change in relationship between shareholders and companies. The past decade has seen activist investors pursuing more than 2,000 campaigns to redirect business strategies, activities, and resources, about 40 percent of which involved some form of merger or acquisition. In many cases, the activists actually forced assets into play.

Traditionally, such activity was viewed as a threat, but that may be changing. Activists increasingly are coming prepared with ideas for growing shareholder value and improving business performance. Of the more than 2,000 executive participants in a recent Deloitte Dbriefs Webcast poll, 83 percent believe activism is good for shareholders and public companies.

Nevertheless, board members shouldn't wait for activists to make moves. They should be prepared by clearly understanding the value drivers of the business and considering ways to improve them. The board and management should work together to understand activists' interests and motivations, recognize factors that can cause them to take action, and respond swiftly and decisively if an inquiry surfaces.

Activism drivers

Activists often believe that companies with large cash holdings should put it to work or return it to shareholders. They want to avoid the types of major losses investors incurred in the last recession. And, they want to know how directors and management plan to steer companies in an increasingly regulated, global, and uncertain economy.

Activists have different areas of interest. Some focus on income statements with an eye toward performance improvements. Others are balance-sheet driven, looking for opportunities for special dividends or share repurchases, divestitures or spinoffs, or company or asset sales. Governance issues may be drivers, with the focus on board composition, CEO or management change, and compensation. Still other activists may have a social agenda such as environmentalism, human rights, or corporate citizenship.

What board members can do

Here are some steps directors can take to think like an activist:

Evaluate vulnerabilities. Possible triggers for activist interest can include strong cash flow, high cash balances, captive or underperforming assets, or significant non-operating assets. Capital structure or dividend policy may be seen as overly conservative. The business's profile may have changed significantly, perhaps through M&A. Takeover defenses may be inadequate, or environmental or social policy may raise red flags. Regular, objective analysis of the performance, value, and governance of the company through an activist lens can help anticipate possible initiatives.

Monitor market activity. Recent changes in shareholder mix, behavior, or interaction can signal activism. Other signs can include activists targeting peer companies, negative media or analyst attention, and increasing social media activity. It is important to establish a methodology for monitoring changes in the company's performance, or its value across the portfolio of businesses and assets, as well as shifts in industry perception and peer group trading activity. Regular, two-way communication with shareholders can provide signals of potential activist moves.

Have a response plan. Directors and management can create a plan based on an objective understanding of strategic alternatives, the company's value drivers, and the value of its component parts under various scenarios. A compelling, fact-based point of view can be formulated to demonstrate how management's strategy creates opportunities to realize value.

It is important to understand investor expectations, investment horizons, and requirements. Thinking this way can help board members and management determine if the company has a clear and compelling investment thesis that is fact-based and whether the company's strategy and operating and financial metrics are aligned with investor expectations.

Activist investors increasingly are well prepared when approaching boards. Directors, too, can prepare by understanding the motivations that drive activists, recognizing issues that can potentially put the company in their crosshairs, and having a plan to address activists concerns.

Chris Ruggeri is a principal and M&A leader of Deloitte Transactions and Business Analytics LLP, and Justin Silber serves

as a managing director for Deloitte Corporate Finance LLC.