

Activist Investors:
Keeping ahead of the Activists
Part 1

Preface

As a business executive or board member of a listed company, you will be aware of the market presence of Activist Investors. Their involvement in a company is often destabilizing, both for the business and its management, whether they bring valid challenge and benefits for shareholders or not. It may therefore make sense to prepare a defense against an unwelcome approach. You may suspect that an Activist Investor is about to target your company, and it may be difficult to make the changes that would be required to avoid their attentions entirely. This paper looks at the features of a company that attract Activist Investors, and what can be done in short order to improve the chances of retaining control and delivering value with or without an Activist Investor's disruptive presence.

In our previous report, [Be your own activist](#), we highlighted the increasing trend for Activist Investor campaigns in Europe and other non-US markets. For example, in Europe there are more than twice the number of campaigns now than there were 5 years ago, whilst in Japan growth has been higher still making it the busiest non-US market in 2019. In this report we look at how far non-US markets have to go to catch up with the US. We also investigate which factors – influenceable or otherwise – affect the likelihood of being targeted.

We have spoken with executives from across the C-Suite and in other leadership roles, who have all been on the receiving end of an Activist Investor campaign, to obtain insights into how best to prepare for activists and engage with them when they appear. These insights highlight the variety of styles and approaches taken by Activist Investors, as well as the outcomes they seek. Of those we spoke to, some had been targeted by the largest and most sophisticated Activist Investors, and some by those that do little more than chase vulnerable leadership teams; some had experienced Activist Investors who sought to work collaboratively with management, whilst others had received hostile criticism from the outset.

Our analysis also suggests how certain activities and company characteristics increase exposure to, or increase the risk of a campaign before any underlying strategic change can be put in place to prevent it. Even if it is too late to avoid the interest of an Activist Investor entirely, there are still useful steps to retain the initiative and control over the process. The sooner these steps are taken, the lower the risk will be of an Activist Investor campaign that can destabilize the company and its leadership.

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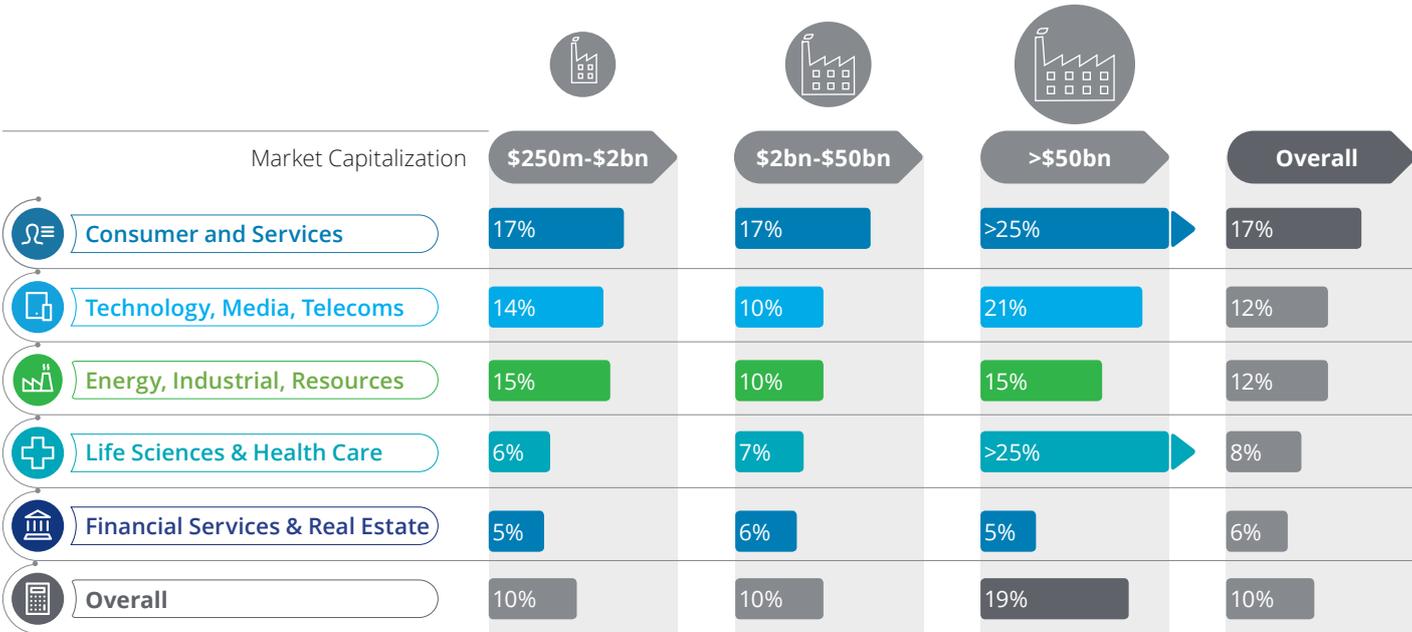
The mature US market

US companies have been the traditional hunting ground of Activist Investors. Deloitte research has shown how over the past five years, one in 10 US listed companies with a market capitalization in excess of \$250 million have been subject to a campaign by financially-motivated Activist Investors¹.

These penetration rates are much higher for particular sectors, industries and sizes of company. For example, among Consumer and Services companies with a market capitalization over \$50 billion, more than 1 in 4 companies have been targeted during this period.

Figure 1. Penetration rates of Activist Investors with US public companies

Analysis of 3,800 US public listed companies in the last five years, with market capitalizations >\$250 million and Activist Investors with a primary or partial focus on Activist Investor strategies



Note: Penetration rate is defined as the number of companies with holdings announced by Primary or Partial Focus Activist Investors as a percentage of the total population for that sector and market capitalization.

Source: Deloitte analysis, Activist Insight data, Thomson Reuters EIKON.

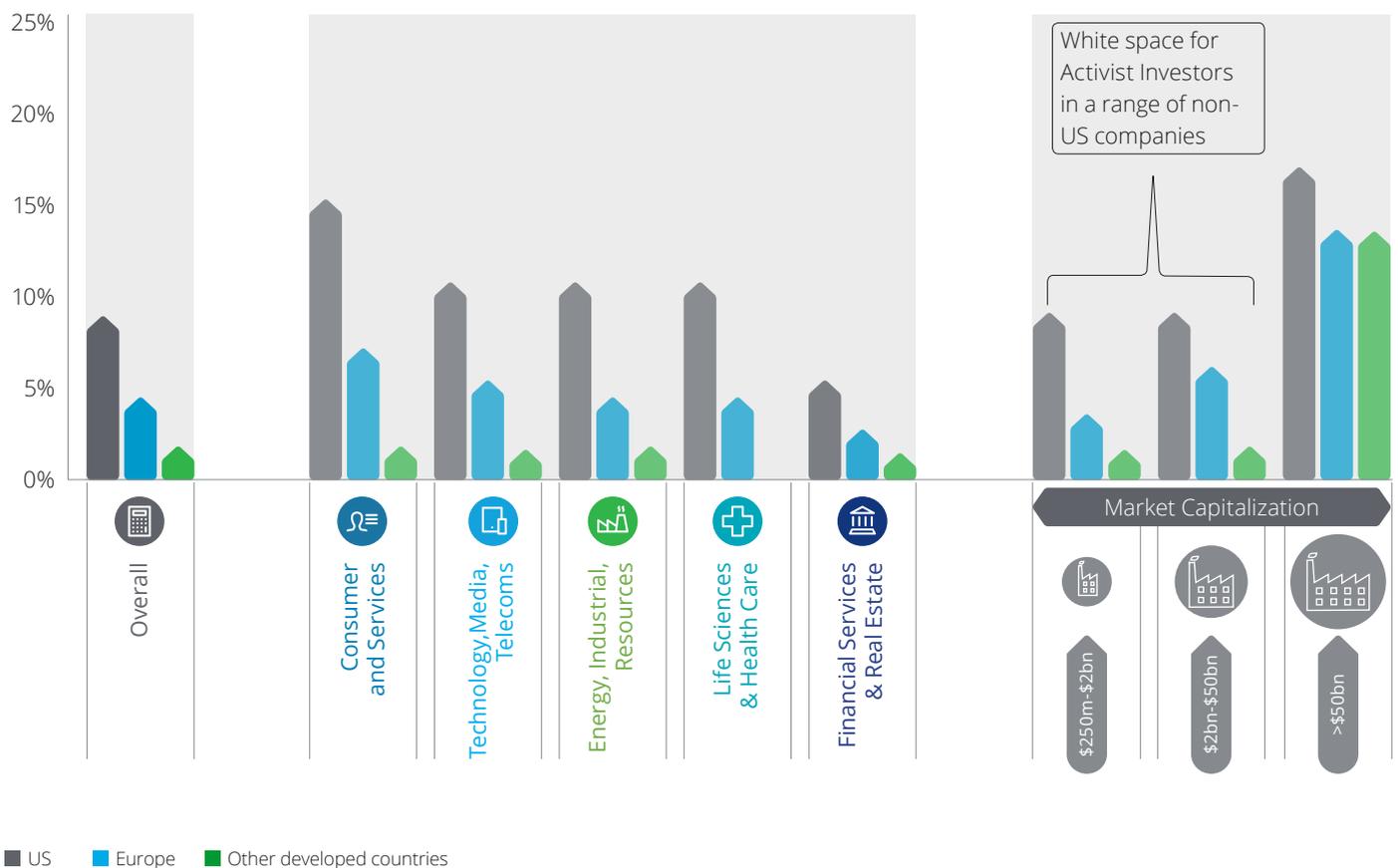
Relative maturity outside the US

Outside of the US, growth in Investor Activism over the last five years has been fast - more than doubling in Europe and approaching tripling in the rest of the world but from a low base. As a result, markets in major developed countries in Europe, Asia and beyond show less than half of US levels of penetration, suggesting that this growth in Investor Activism still has some way to go. But with increasing publicity of Activist Investor campaigns and tactics, CEOs and other board members will be given little leeway by other investors in how they lead the company and address any Activist Investor involvement as and when they approach.

The risk of being the target of an Activist Investor campaign depends on various factors, both internal and external.

Figure 2. Activist Investor penetration rates comparing US and other major developed countries

Percentage of public listed companies subjected to a campaign in last five years



Note: Public companies with market capitalization greater than \$250m.

Activist Investors with Primary or Partial focus.

Europe comprises of the UK, France, Germany, Italy, Spain, Switzerland, the Netherlands and Sweden.

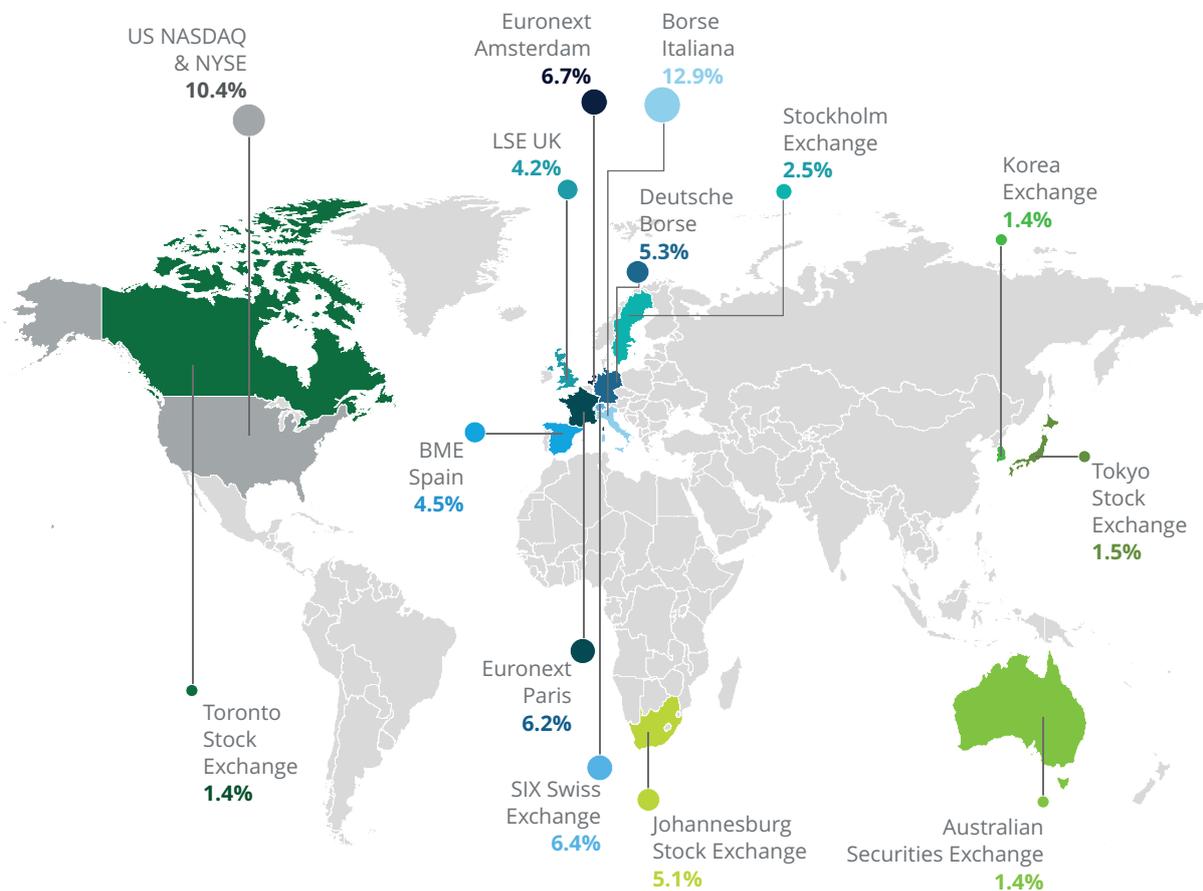
'Other developed' comprise Japan, Canada, Australia, Korea and South Africa.

Source: Deloitte analysis, Activist Insight data, Thomson Reuters EIKON.

Be aware of where you operate...

Governance rules and regulators have an impact on how Activist Investors can operate, and some markets (as a proxy for the company's country of registration) appear much more accessible to Activist Investors. In others, it is easier to defend against their advances. Across markets, penetration levels vary considerably, and the prevalence of activist campaigns and their associated success rates are, at least in part, a reflection of local conditions.

Figure 3. Activist Investor penetration rates for select major around developed stock market exchanges
Percentage of public listed companies subjected to a campaign in last five years



Source: Deloitte analysis, Activist Insight data, Thomson Reuters EIKON.

For example, in the Italian market there have been high levels of Investor Activism activity across all sizes of company. Whilst it may simply be that historically, Italian companies have been less challenged on performance, other factors may be at play, such as the degree of influence available to the largest minority shareholders. By becoming the dominant minority shareholder, an Activist Investor is offered a more straightforward route to a seat on the board, from which it is in a better position to agitate for and win acceptance of its demands.

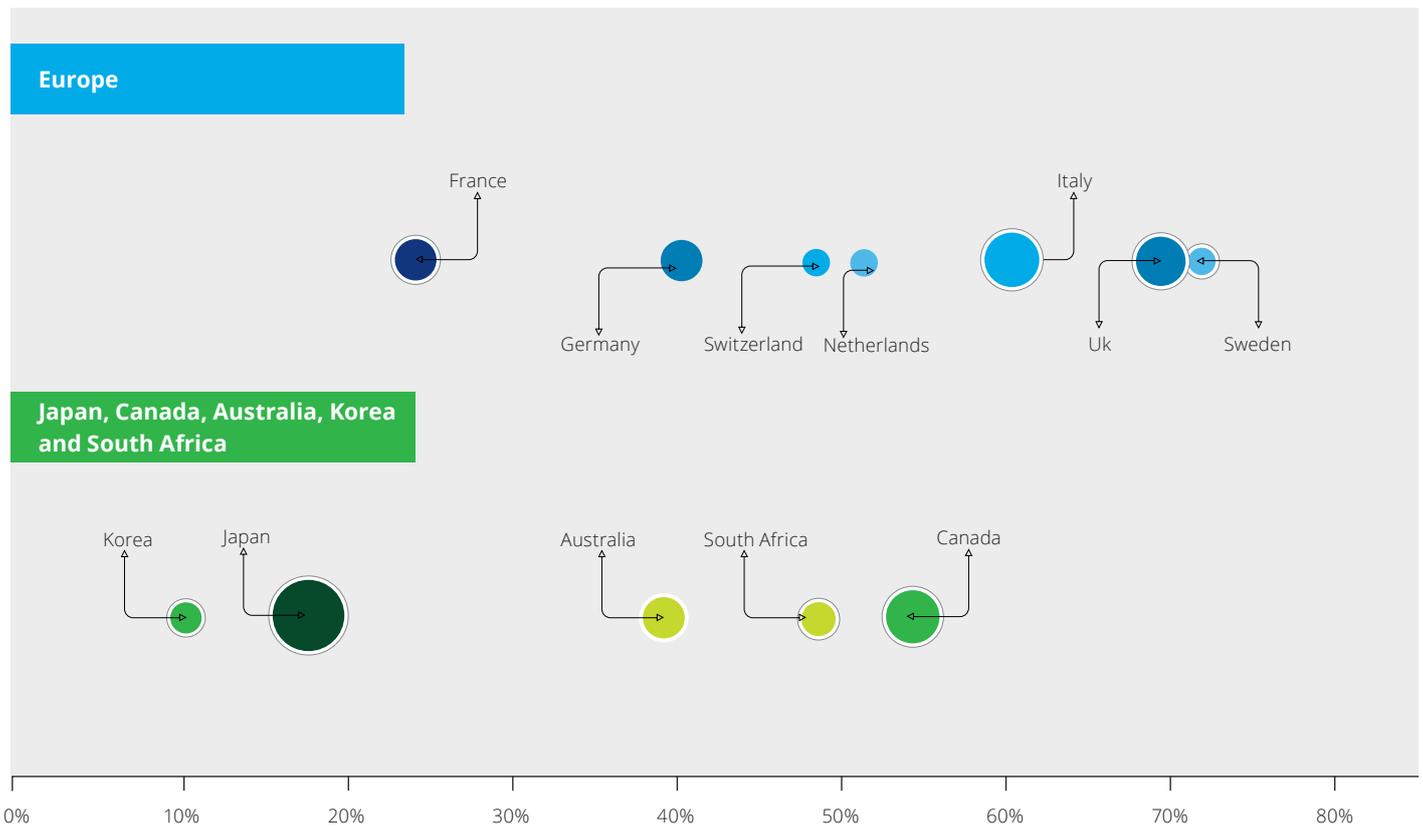
The impact of Brexit uncertainty on the attractiveness of the UK for Activist Investors is interesting in light of relatively low penetration rates. That said, the UK continues to be the most active market *in absolute terms*, suggesting that the fundamentals that interest Activist Investors have still won out despite the uncertainty.

In France, the Florange law (offering long-standing shareholders increased voting rights²), the Danone Law (protecting strategic industries from foreign takeovers³) and other factors that require longer-term investment before shareholding rights are fully activated, do not seem to deter Activist Investors: French penetration rates are at the upper end of the range in Europe. However these hurdles may be a barrier in getting companies to concede to Activists' demands, as success rates (see Figure 4) are substantially lower in France than in other markets. Furthermore, French authorities⁴ seem intent on pushing further, with recent moves to enforce greater transparency surrounding short-seller and Activist Investor interests in French listed companies⁵.

Having an understanding of how local conditions, rules and regulations expose or protect a business from Activist Investors, can help a board of directors to plan accordingly by maximizing leverage from the available defences, or to address weaknesses related to local factors.

Figure 4. Activist Investor success rates with demands for select non-US markets

Percentage of demands deemed successful or partially successful (ongoing demands excluded)



Note: Success rate of demands made by Activist Investors with Partial/Primary focus, based on selected locations of companies' headquarters. Circle size reflects number of demands made.

Source: Deloitte analysis, Activist Insight data, Thomson Reuters EIKON

... how big you are...

Outside the US, penetration rates are highest among companies with a market capitalization above \$50 billion, with rates approaching US levels. Large Consumer & Industrial companies have been the focus of much of the initial wave of Investor Activism in Europe, attracting both US and local Activist Investors.

US Activist Investors coming to Europe are typically the larger US players with deep pockets. Consequently their positions are larger in absolute terms (more than twice those of local Activist Investors, and closer to four times in the UK).

Figure 5. Penetration rates of Activist Investors with European and other select non-US markets

Analysis of public listed companies, with market capitalizations >\$250 million and Activist Investors with a primary or partial focus on Activist Investor strategies

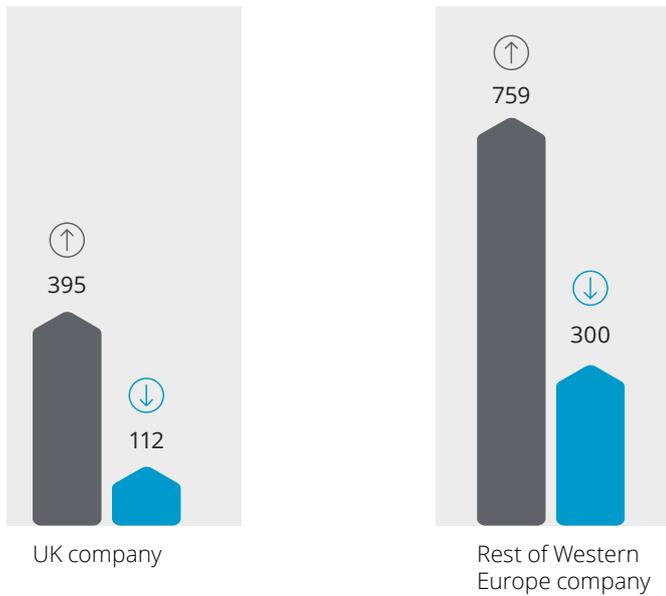


Source: Deloitte analysis, Activist Insight data, Thomson Reuters EIKON.

Figure 6. Holding sizes for US and non-US Activist Investors with European companies

Value of investment held by Activist Investors alongside public demands*

Size of holding, \$m average



To date, Activist Investors have shown less interest in small- or mid-size companies outside the US. For example, the UK is seen as a dynamic market for Activist Investors, but penetration rates overall are far below US levels. As markets become more used to activism and more home-grown Activist Investors emerge, penetration rates in smaller companies are likely to catch up with those in the US.

■ US Activist Investor ■ Non US Activist Investor

Public shareholding >0%

Note: *Average holdings include those announced and where public demands have also been made by the Activist Investor.

Source: Deloitte analysis, Activist Insight data, Thomson Reuters EIKON.

...and the sector you operate in

Certain sectors have barriers against Activist Investors; for example they may be deemed “strategic” by regulatory bodies or have more complex capital requirements. Companies may be able to leverage any such defences in their sector. Total Shareholder Return (TSR) and high level financial metrics are typical focus points for Activist Investors seeking to highlight poor relative performance. However, companies should also consider whether they operate in a sector where other measurements of poor relative performance are easily highlighted to (and by) Activist Investors and thus provide further means to challenge management performance, e.g. consumer-based data. Sectors in which there is a high level of M&A activity may provide wider M&A-related exit options – a key value delivery strategy for Activist Investors. Activist Investors may refer to the successes of a company’s competitors to highlight perceived deficiencies in management, so pre-emptively preparing a riposte to this line of challenge can be helpful.

Favored sectors for Activist Investors in most of the markets we analyzed, as shown in Figure 5, include consumer, retail, services, auto, tech/media/telco (TMT), industrial and big pharma. The reason for this may be greater transparency or straightforward businesses that are easier to unpick from the outside and whose performance can be compared using data from readily-obtainable sources. Additionally, companies with value-delivery potential for Activist Investors include those that are deemed easier to carve-up (with more potential strategic buyers) and those made up of disparate parts (particularly those that might be labeled as a conglomerate), operating in consolidating industries. There is also evidence to suggest that by embarking on an M&A strategy, a company may attract Activist Investors.

Activists seem less focused on sectors such as mining, utilities, smaller life sciences, banking and insurance where penetration rates can be as low as 1 in 50, and fewer of the big companies have been targeted. However markets such as Canada and Australia still show signs of activity in these sectors. For smaller life sciences companies the lower penetration rates may reflect an aversion among Activist Investors to downside risk: businesses that are not well diversified and depend on a single product’s chances of success – rather than anything the Activist Investor can directly influence – come with an outsized risk of failure. Regulatory requirements, or the need for large capital investments, may also be reasons why other sectors are penetrated less than Consumer, TMT and Industrials.

If a company’s size, location and industry affect its chances of being targeted, do they also affect the type of Activist Investor that may be attracted? Our research shows that this appears to be the case.



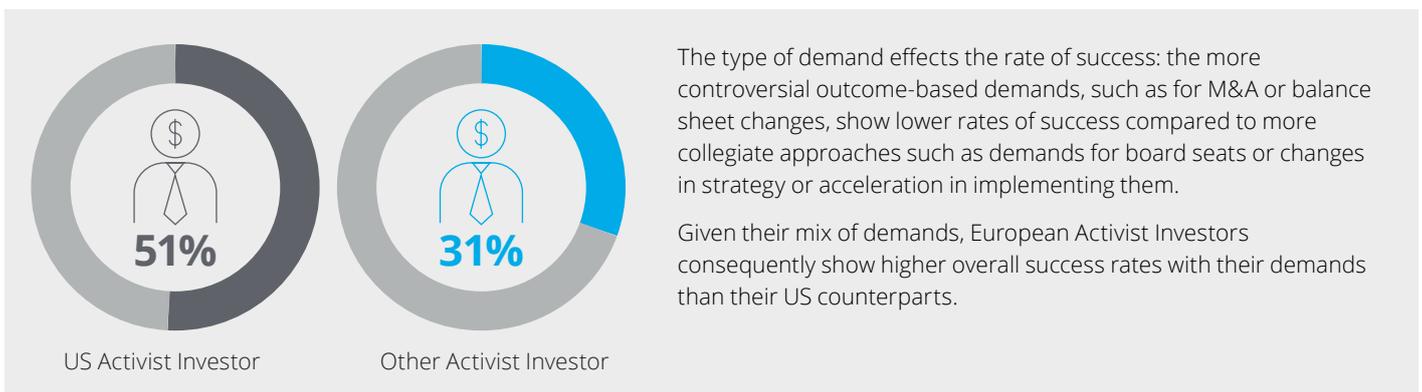
Differences in styles and outcomes for US and home-grown Activist Investors

Analysis of European data shows that the types of demand made by Activist Investors differ according to the country in which their campaign occurs. For example a high proportion of campaigns in the UK have been subject to M&A demands from US Activist Investors, with nearly three-quarters of US campaigns in the UK having an M&A angle – in Europe this has been much lower at 31%.

Differences in objectives between US and European Activist Investors could also be seen in the sizes of stakes taken (see Figure 6), and the willingness of Activist Investors to take more time to seek consensus with management. We found that US-based Activist Investors are typically more inclined to go straight for an outcome that provides a return, rather than taking a more roundabout route to achieving their objectives. Half of demands by US Activist Investors were for direct changes (e.g. to the balance sheet, via share buy-backs or radical M&A) compared to fewer than one in three among their European counterparts. Home-grown Activist Investors in Europe were more inclined to use collaborative approaches, with more demands for indirect steps such as board changes, and changes in operations or strategy.

Figure 7. Straight-talking for US and non-US Activist Investors

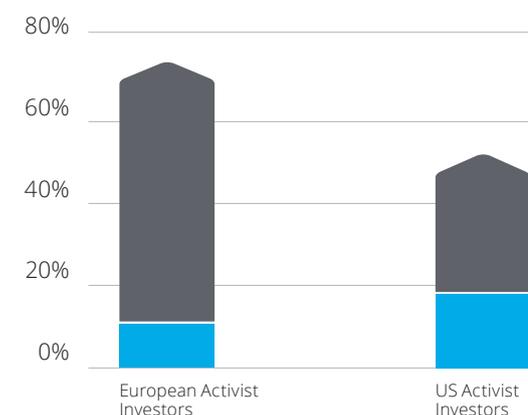
Proportion of demands by Activist Investors on European companies that relate to “Quick wins”, which include balance sheet changes and return of cash, share buy-backs or M&A (% of total demands)



Source: Deloitte analysis, Activist Insight data, Thomson Reuters EIKON

Figure 8. US and European Activist Investors’ success rates with demands on European targets

Percentage of demands deemed successful or partially successful (ongoing demands excluded), highlighting those with an M&A perspective



■ Success rate ■ of which M&A activism success rate

Source: Deloitte analysis, Activist Insight data, Thomson Reuters EIKON

Implications for management

So what are the implications for the leaders of public companies? Whilst a company's country and industry, along with its relative performance, may increase the risk of attracting an Activist Investor and influence their line of attack, there are also other important factors that can turn an Activist Investor's investment business case into an actionable campaign.

Our interviews with executives highlighted suspicions that established shareholders have sometimes invited Activist Investors to become involved in order to lend gravitas to more widely held views on under-performance and to act as a catalyst for a change in business strategy. Furthermore, executives felt that Activist Investors may make demands around Environmental, Social and Governance (ESG) issues in order that other investors feel more comfortable supporting their campaign. So keeping abreast of wider issues and sentiment around performance is important, in order to avoid challenges from unexpected directions.

In our previous report, *"Be your own activist"*, we highlighted nine aspects on which to challenge a business to avoid Activist Investor interest. However, it is useful to consider a wider range of parameters that an Activist Investor assesses before launching a campaign.

These parameters may simply flag an opportunity, help to win allies among other shareholders, indicate a way to drive financial improvements, or create a return if something can be corrected.

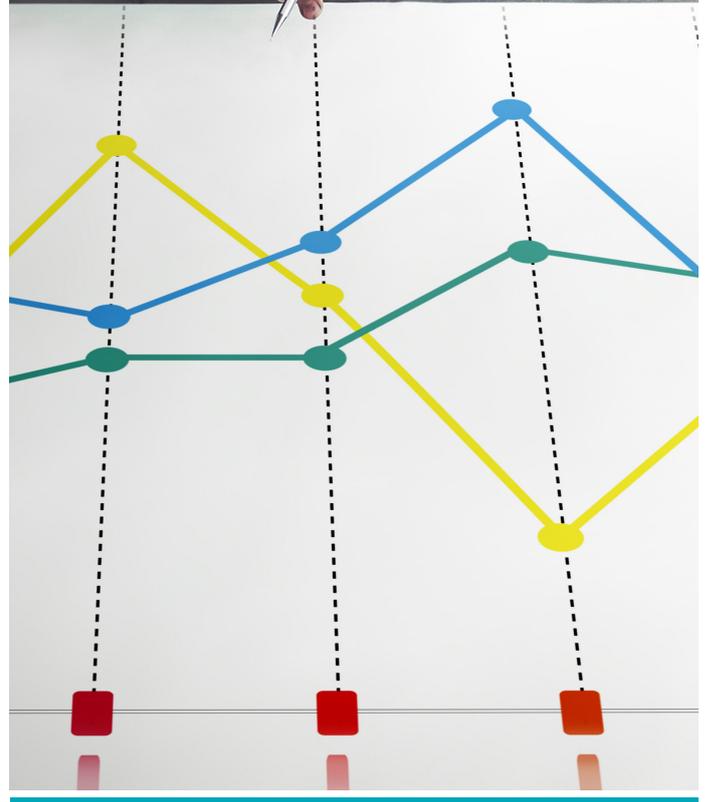


Figure 9. Selected parameters and features of interest to Activist Investors

Features of companies that can influence whether they are targeted by Activist Investors

	Financial/quantitative	Soft/qualitative
Flags: features that attract an Activist Investor's attention	<ul style="list-style-type: none"> • Low (comparative) total shareholder returns • Lower margins and financial metrics 	<ul style="list-style-type: none"> • History of past acquisitions not welcomed by the markets • Negative voting (e.g. on say-on-pay votes)
Grips: features that allow easier traction with other investors	<ul style="list-style-type: none"> • Limited cost savings/synergies delivery • Low (relative) growth rates • Limited or decreasing inter-divisional synergies 	<ul style="list-style-type: none"> • Combined roles (CEO/Chair), board composition • Reports/rumors negatively portraying performance and leadership
Levers: features that provide a means to change performance	<ul style="list-style-type: none"> • Public vs strategic owner valuations of business units • Excess cash on the balance sheet 	<ul style="list-style-type: none"> • Strategic rationale for current combination/ observation of non-core assets and businesses
Returns: features that can directly lift TSR	<ul style="list-style-type: none"> • Multiples and other valuation ratios trading below comparators 	<ul style="list-style-type: none"> • Changing the board composition as indicator to market of broader change

Source: Deloitte analysis

Other corporate actions or material changes in strategy can bring companies to the attention of an Activist Investor, or simply provide an opportunity for "Bumpitragism" (whereby Activist Investors step into an announced acquisition to demand a higher price) and other reactive measures. To avoid unwanted disruption company leaders should develop a keen awareness of the sorts of activity that draw the attention of Activist Investors (such as a proposed M&A deal) and they should plan around or for them accordingly, for instance within the phasing and communication of changes to the market.



Conclusion

Investor Activism outside the US still has some way to go to meet the levels seen in the US, and a continuing increase in activity may be expected. Company leaders should be prepared to respond by developing an awareness of the impact that their company's circumstances have on its attractiveness to an Activist Investor, as well as the type of Activist Investor it might attract.

Improvements in company performance can reduce the risk of a campaign, but failing that there are other tactical ways of reducing the risk of attracting attention or the traction that an Activist Investor might have.

When an unwelcome campaign is launched by an Activist Investor, the company's leadership should have a plan in place, tailored to the circumstances; but there is still much to do to communicate with other investors and the market. Advance preparation should also strengthen the personal resolve of the company's leaders, who will be in the spotlight throughout the process, and ensure a successful return of the company to a future unencumbered by the presence of an unwanted Activist Investor.

This report is Part 1 of a 3-part series on Activist Investors. Visit www2.deloitte.com/global/activistinvestors to find out more.



Footnotes

¹ Activist Investors refers to financially minded “Primary Focus” or “Partial Focus” Activist Investors who attract capital for the purpose of delivering returns to investors that are principally or often based on Activist Investor strategies as opposed to those motivated predominantly by, say, environmental.

² “Impact of Florange Act (France)”, ISS Governance [<https://www.issgovernance.com/file/publications/impact-of-florange-act-france.pdf>]

³ “French government extends powers to veto foreign takeovers amid concern over Alstom deal” [<https://www.pinsentmasons.com/out-law/news/french-government-extends-powers-to-veto-foreign-takeovers-amid-concern-over-alstom-deal>]

⁴ French lawmakers urge tougher disclosure on activist investors, Reuters, 2 October 2019 [HYPERLINK “https://global.deloitteresources.com/Services/mandata/Pages/Research_tools_897879.aspxhttps://www.reuters.com/article/france-shareholders/french-lawmakers-urge-tougher-disclosure-on-activist-investors-idUSL5N26N55L” French lawmakers urge tougher disclosure on activist investors]

⁵ Activist investors lay down challenge to corporate France, Financial Times, 29 November, 2019 [https://global.deloitteresources.com/Services/mandata/Pages/Research_tools_897879.aspxhttps://www.ft.com/content/02eadd92-11d3-11ea-a225-db2f231cfeae]

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