Activist Investing in Europe

2022

Activistmonitor
An Acuris company

Skadden

Contents

Foreword

Companies should prepare for a surge in activism, including ESG-based demands.

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Head of Skadden's European M&A practice

As anticipated, the Covid-19 crisis and its consequences have increased shareholder activism pressure on European companies. Though activism may have seemed less pronounced in 2021, this was only due to the decrease in public campaigns.

Actually, the level of activism remained very high in 2021, and a large number of European companies are at risk of being targeted by activists in the future through either private demands or public campaigns.

Until now, shareholder activism had mainly been about interactions between activists and boards. But, in 2021, the (large) institutional shareholders gained a central role between activists and issuers, as they seemed more willing to listen and accompany activists in their demands.

Institutional shareholders can tilt the balance either in favour of activists (by increasing the weight of their credibility and their demands towards the board of the company) or in favour of the companies (as they represent one of the most efficient preventative measures against any attempt from activists). As such, an open and constructive dialogue with large (institutional) shareholders remains key for companies and their boards.

Nonetheless, even if not supported by large institutional investors, activists can, and will, continue to go public, and issuers should be prepared to respond in a timely and effective manner – even if the response is to ignore the said activist.

In addition, it appears that in 2021 activists strengthened their demands with respect to environmental, social and governance (ESG) and are increasingly eager to promote better ESG practices or to use ESG aspects as a tactical element. However, such promotion by activists of ESG should not hide the fact that most of their demands relate to issues regarding governance and distribution to shareholders (dividends, share buy-backs, etc.).

Backed by (large) institutional shareholders and/or appearing as champions of ESG, activists will not hesitate to challenge and launch public campaigns against issuers. This being said, issuers should be fully prepared, adopt a clear strategy, and not fear public confrontation to the extent necessary to protect itself and the stakeholders' interest.

Out of the frying pan and into the fire

After the economic dislocation of the pandemic, an acceleration in shareholder activism is on the horizon, with new and onerous fronts on which to fight.

Activist investors are re-emerging after the Covid-19 crisis with a ravenous appetite. With pandemic-related disruption still distorting markets and exposing corporate weaknesses, 2022 could be a year of extensive confrontations between activists and company boards.

In last year's edition of this report, we revealed that activist investment had bounced back following a lull during the first months of the global pandemic and predicted that, with growing numbers of activists entering the fray, flashpoints would continue to proliferate in 2021. Twelve months later, this year's report confirms that our expectations were accurate and, perhaps more importantly, that there is every prospect of an acceleration in activism in the year ahead.

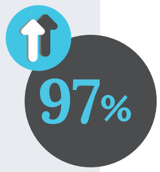
It is not only the pandemic's impact that is fuelling this trend; the other crucial factor is an increasing focus on environmental, social and governance (ESG) factors. With an increasingly broad range of stakeholders – from investors and corporates themselves to employees, regulators and policymakers – focusing on such issues, ESG will inevitably be at the heart of a growing number of campaigns.

Against this backdrop, it has never been more important for corporates to engage consistently and openly with various shareholders. Building closer, more trusting relationships with a larger number of investors will not only mitigate the risk of activist campaigns, but also give boards and senior management better chances of retaining support if a confrontation does arise.

Equally, however, boards must recognise that actions speak louder than words – and that activist investors are ready to put up a fight. Corporates and their senior executives must address the issues that activists are likely to target, particularly as the pandemic has exposed new fault lines. And they must be prepared to deal with campaigns, whether private or public, with a clear strategy for protecting the company and responding to demands. Proactive, meaningful engagement must be the order of the day.

Our key findings include:

1. Over the last 12 months, 60% of corporates report that they identified **new weaknesses that activists might exploit** and have already discussed those with shareholders. Not one respondent reports that they failed to identify a new weakness.



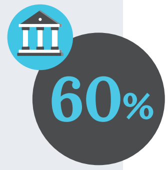
2. 97% of corporates anticipate an **increase in shareholder activism over the next 12 months**, including 60% who are expecting a significant increase.

3. Almost all respondents (98%) believe **companies in Europe should be very concerned about becoming targets from North American activists over the next 12 months**, while 88% and 70% of respondents report the same about UK-based and European activists, respectively.

4. The vast majority of corporates (86%) are anticipating an **increase in strategies of visible, public activism**. Such concerns are confirmed by activists surveyed, 54% of whom likewise agree or strongly agree that public activism will come to the fore.

5. 40% of corporate respondents maintain that **new ESG disclosure requirements will not have a discernible impact on campaign demands**, whereas 53% of activists surveyed believe it will lead to a significant increase.

6. Once a public campaign has broken out, a significant share of corporate respondents (34%) consider **investor engagement as the most important defensive tactic**, followed by communication with the activist (23%). Activists, however, disagree entirely—not one activist believes such communication is a good tactic. Instead, 40% recommend that the company ignore the activists' demands.



7. Over 60% of respondents agree that **increasing engagement between institutional investors will greatly diminish the role of activists**. Activists are much more mindful of this compared to last year, with 47% agreeing and a further 33% strongly agreeing that such engagement could diminish their influence.

Methodology

In November and December 2021, Acuris Studios surveyed 35 corporate executives from listed companies and 15 activist investors from the UK, France, Germany, Italy and Switzerland to gain insights into key trends in Europe's activist investing space. All responses are anonymous, and results are presented in aggregate.

Part 1: Firms navigating new and constant pressures

Activists afforded boards a little benefit of the doubt during the pandemic – but the threat of campaigns was never far from corporates' minds.

Investor activism is infiltrating throughout Europe, with 2021 having seen activist shareholders target a broad range of companies, particularly in the UK. The number of open live campaigns in Europe totalled 302 at year end, data from Activistmonitor reveals, representing a 16% increase from the end of 2020.

Those included 41 new campaigns launched against European companies over the course of the year. New campaigns in the UK (20) accounted for just under half of that number as the fallout from Brexit continued, undermining valuations already imperilled by the pandemic. The Netherlands (with six), France (with five), Switzerland (three), Germany and Italy (two each), and Belgium, Spain and Sweden (one each) accounted for the remainder.

Overall, public activist activity decelerated by 29% from 2020, when shareholders launched 58 campaigns. That disparity may mostly reflect the surge in campaigns launched in H2 2020, when some of the volatility connected to the Covid-19 crisis first eased. But it is also down in large part to a sharp fall in campaigns in continental Europe. While the number of campaigns in the UK remained steady, activism was down in Germany (where 10 new live campaigns were launched in 2020), France (seven), the Netherlands (six), Italy (four) and Belgium (four).

Another factor at play was the decline in the number of smaller businesses coming under attack from activists. While 2020 saw 25 new live and potential campaigns launched against companies with a market capitalisation of less than US$1bn, there were only 15 such interventions in 2021. The largest companies were also less likely to be targeted, with 19 campaigns against businesses with a market capitalisation of more than US$2bn in 2021, down by more than a third from the previous year's 33.

The nature of the demands being made by activists has also evolved. While the decrease in the number of live campaigns has led to a corresponding decrease in volume across most categories of demands that activists have made, these did vary significantly.

In 2021, as in 2020, the most common demand was for a particular board appointment as activists sought to install their preferred representatives. Demands for governance changes and an overhaul of management or the existing board were also common.

> Historically, Europe has not been a hotbed of investor activism compared to the UK or the US. Given the uptick in public campaigns in H2 2020, the renewed uncertainties related to the pandemic and other risk factors, from interest rate developments to supply chain issues, it is not wholly surprising that, overall, there was a decrease in public campaign activity in 2021.
>
> Holger Hofmeister, Partner in Skadden's Frankfurt office

Live campaigns in Europe

The only type of demand that saw a meaningful year-on-year increase was oppositions to a bolt-on, divestiture or spin-off, climbing from 1 in 2020 to 4 in 2021. Conversely, the types of demand that saw the most conspicuous declines were requests for discussions (from 7 to none) and calls to reduce costs or make operational improvements (from 14 to 4).

As for the identity of activists, Activistmonitor's data reveals that Bluebell Capital Partners, a London-based investment company, and Elliott Management, based in New York, were jointly the most active in Europe in 2021, each launching five public campaigns. Thereafter came a three-way-tie – Wisconsin-based Artisan Partners, UK-based Asset Value Investors and Dublin-based Causeway Capital each logged two.

Ubiquitous threats

In the face of these campaigns, to say nothing of generalised pandemic-related unease, many boards are feeling the pressure. Every respondent to this survey was approached by an activist at least once over the past 12 months, with 31% receiving three or four approaches. Most corporates (66%) report only one or two approaches – and of course, not all of these discussions led to public launches – but this level of engagement demands attention and can prove very taxing in the aggregate.

Indeed, the threat of activist campaigns has become an increasingly important topic of discussion for boards: 74% say proactive discussions about the threat of such campaigns have taken place more frequently, including 48% who say these discussions were held far more frequently over the last 12 months. Not one respondent reports having had such conversations with less regularity.

Total campaigns by market capitalisation (live & potential)

Market cap	2020	2021	Growth
<US$1bn	25	15	-29%
US$1-2 bn	7	7	0%
>US$2bn	33	19	-37%
Total	**65**	**41**	**-29%**

Boards are conscious that these discussions must address the potential for activist campaigns to spread from almost anywhere, with both local and non-local activists featuring prominently. Indeed, 57% of corporates say they were approached equally by activists from both home and abroad – and while 34% say most approaches were local, it is clear that activism is an international pursuit.

One may consider that domestic activists may know the local companies better, as suggested by a board member at one Italian company. "Over the last 12 months, it was local activists that approached us – in local business circles, our vulnerabilities are more widely understood," the director says. But equally, the CFO of a German corporate argues: "Local and non-local activists share online information sources – and activists from the US and Asia have increased in number because their economies are stabilising."

Another possibility is that the global nature of the Covid-19 crisis has encouraged shareholders to think more internationally. "Post-pandemic, there has been an increase in the number of non-local activists approaching us," says a board member at a Swiss corporate. "Before, it would only have been the local activists who approached us to discuss details about market volatility and the impact on returns."

> Longer-term shareholders and financial sponsors are increasingly having to articulate their positions on issues like ESG, which has had a knock-on effect on the level and form of dialogue with their investee companies.
>
> Bruce Embley, Partner in Skadden's London office

Many corporates also report an increased focus on their activities from a broad range of market participants. In particular, every corporate respondent to this research says hedge funds have become much more vocal as activists over the past 12 months, while 74% say the same of private equity firms.

Also notable is the impact that new entrants are having on the activist environment. Almost every respondent (97%) reports having faced more vocal interventions from first-time activists in 2021, and 74% say retail investors have been notably more active. Clearly, in this environment, activist investors may emerge from any section of the shareholder base, and only a small handful of corporates say they have seen a decrease in activism from any source.

Foretelling flashpoints

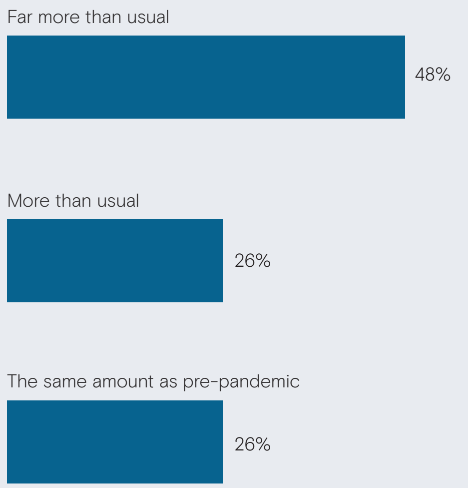
With so much nervousness around the prospect of shareholder activism, company boards are thinking hard about potential points of conflict. Inevitably, many businesses are in a different position in the wake of the Covid-19 crisis, exposing vulnerabilities that activists could exploit. The rise of the ESG agenda creates other potential flashpoints, particularly as new regulation in many markets and industries requires companies to make more public disclosures about their performance.

Boards are striving to identify these issues, with every corporate in this research conceding that they have identified new weaknesses that could attract activists' attention. Many of those companies (60%) have sought to head off conflict by engaging with long-term

Demands made in open live campaigns

	2019	2020	2021	Y-o-Y 2021
Discussions	1	7		NA
Special meeting	2			NA
Cost reductions/ Operational improvements	5	14	4	-71%
Share buy-back/Dividend/ Return of capital	8	10	7	-30%
Acquisition/Merger agreement	5	3	4	33%
Oppose acquisition/ Merger agreement	6	8	7	-13%
Bolt-on/Divestiture/ Spin-off	13	13	15	15%
Oppose bolt-on/ Divestiture/Spin-off	1	1	4	300%
Strategic alternatives	2	10	7	-30%
Capital allocation/ structure changes	6	10	4	-60%
Governance changes	12	16	17	6%
Management/ board Changes	12	17	15	-12%
Board member(s) appointment	11	26	18	-31%
Environmental/ social changes		2	2	0%
Total	**84**	**137**	**104**	**-24%**

Over the last 12 months, how often has your board proactively discussed the threat of activist campaigns? (Select one)



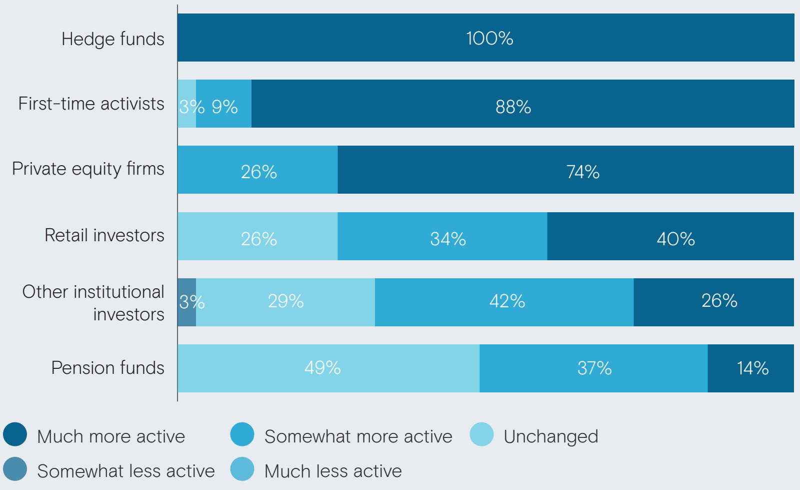
shareholders, discussing the weaknesses identified and how they might be resolved.

Views differ on the best way forward. On the one hand, the CEO of a French corporate says the company must work with shareholders. "To anticipate any increasing concerns about the performance of the company in the next year, we have to engage shareholders and maintain a good level of trust," the executive says.

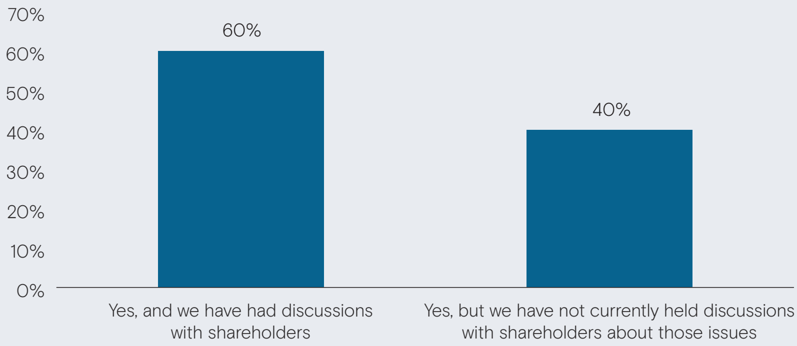
On the other hand, the CFO of a German corporate worries that raising issues with shareholders might be alerting them to problems they had not previously worried about. "We have identified weaknesses but have not held discussions," the executive says. "We are unsure about the right method to proceed with the information at hand – we don't want to create any unnecessary problems."

Discussions with shareholders are not the only way to mitigate the risk posed by activists. Many companies are already thinking about defence mechanisms that would provide protection in the event a campaign is launched: 34% of corporates surveyed say they have considered adopting poison pill provisions and plan to put these in place in the near future, while a further 9% have already made such changes.

Over the last 12 months, how much more or less active/vocal have the following types of activists been compared to the preceding 12 months? (Select one option for each activist type)



Over the last 12 months, have you identified any new weaknesses that could be raised by activists in potential campaigns? (Select one)



Irrespective of size, sector or success, every listed company in Europe should have an activist defence strategy in place and should assume that it will need to engage with potential or actual activists as part of its routine investor engagement activities. And every director should feel empowered to test the strength and quality of the strategy and the engagement.

George Knighton, Partner in Skadden's London office

Part 2: A new age of investor engagement

In the activism arena, ESG will emerge as the next major battleground. For boards, winning over institutional investors could make all the difference.

Slowly but surely – albeit much more slowly than we all would like, and with ill-fated detours along the way – Europe seems to be emerging from the Covid-19 pandemic. In line with the ongoing economic recovery, respondents are predicting a parallel increase in activism as shareholders begin to pursue campaigns along new lines.

1 Pinning down pandemic vulnerabilities

There is no doubt that boards are bracing for a significant uptick in shareholder activism in 2022. In last year's report, 80% of corporates said they expected to see increased activism over the course of 2021; 12 months later, 97% of corporates now anticipate a rise in such activity in the year ahead, including 60% who expect the increase to be significant. Both figures are up compared to last year.

The impacts of the pandemic will inevitably prompt investors to consider their positions and to look again at their shareholdings. "Activism could increase because of the pandemic's effect on the market," argues the CEO of an activist investor based in Italy. "The revenue of companies has declined and this has affected shareholder returns for a prolonged period of time." This opinion is shared by many corporate respondents, including one CEO in France: "Covid-19 has changed the revenue generation capabilities of European companies – they are more vulnerable than ever."

Many respondents to this research expect the effects of the pandemic to go well beyond increased levels of activism. Covid-19 has caused disruption across Europe's stock markets, creating potential valuation opportunities. And with individual countries – and companies – recovering at different paces, there is scope for further distortions. In this context, 86% of respondents believe the number of unsolicited or hostile takeover bids launched in Europe will increase. That includes 49% who anticipate a significant increase.

> As the pandemic fog lifts, activists and bidders in hostile takeovers will be able to price forward and identify value for which the market is not crediting the target. Boards will complain that this is opportunistic, but they will be exposed until the market is convinced that the inchoate value will be achieved as an independent entity and that belief is reflected in the stock price.
>
> Scott Hopkins, Co-Head of Skadden's London M&A group

Such concern is understandable given the market backdrop, but it is possible that corporates' anxiety will not prove entirely warranted. Activist investors themselves do anticipate a busy year ahead, but they do not appear to be planning a significant step-up in activity compared to 2021.

In total, 73% of activists in this research expect to be involved in more than two campaigns over the next 12 months, down from last year's figure of 86%. Moreover, a year ago 33% of activists thought they would take part in five or more campaigns over the proceeding 12 months; this year, none anticipate such high levels of activity for themselves.

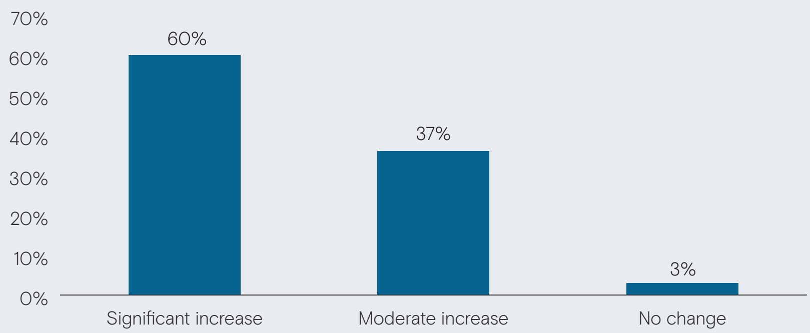
Keeping an eye on US raiders

The UK is expected to bear the brunt of activism in 2022. Almost nine-in-10 (87%) activist investors cite the UK as one of the top two markets in Europe for campaign opportunities over the next 12 months, with half of those investors picking it as their number-one choice.

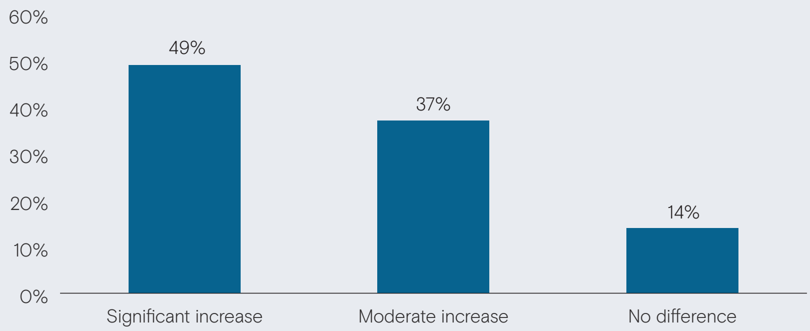
Respondents point out that, in addition to the pandemic's effects, the UK continues to struggle with Brexit uncertainties. "There are higher chances of activism in the UK because of the levels of uncertainty in that market; the pandemic has created excessive operational and growth-related issues for companies there," says a partner at one activist. Another adds: "The best opportunities will be in the UK: there is a lack of stability in markets and companies are still struggling to bounce back following the Brexit disruptions."

Still, it would be wrong to overlook other countries of potential interest. In particular, Italy and Germany, where there was less activity in 2021, are expected to attract interest over the next 12 months. Respectively, 33% and 13% see these countries as the number-one markets for activist campaign opportunities.

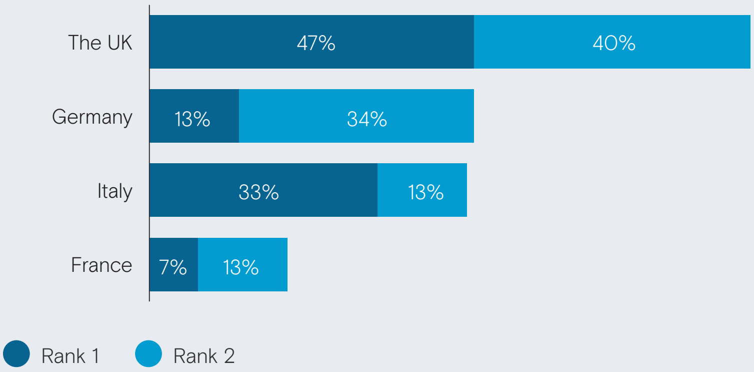
What type of evolution in activity are you anticipating in shareholder activism over the next 12 months? (Select one)



How do you expect the volume of unsolicited or hostile takeovers in Europe to change over the next 12 months? (Select one)



Which European markets do you expect to offer the best opportunities for activist campaigns over the next 12 months? (Select top two and rank 1-2)



> Activists that pursue long-term shifts in corporate strategy largely value private engagement. But opportunistic activists prefer immediate, public confrontation as an effective tool for upping the ante.

Arash Attar-Rezvani, Partner in Skadden's Paris office

Moreover, the increasingly global nature of activism means European businesses could face a campaign that originates anywhere. Almost every respondent (98%) says companies should be very concerned in 2022 about activism coming from North America, while the UK (88%) and mainland Europe (70%) are not far behind. Even the Asia-Pacific region is generating increased levels of intrigue, with 38% suggesing companies should be very concerned about investors from this region, and a further 26% saying they should be somewhat concerned.

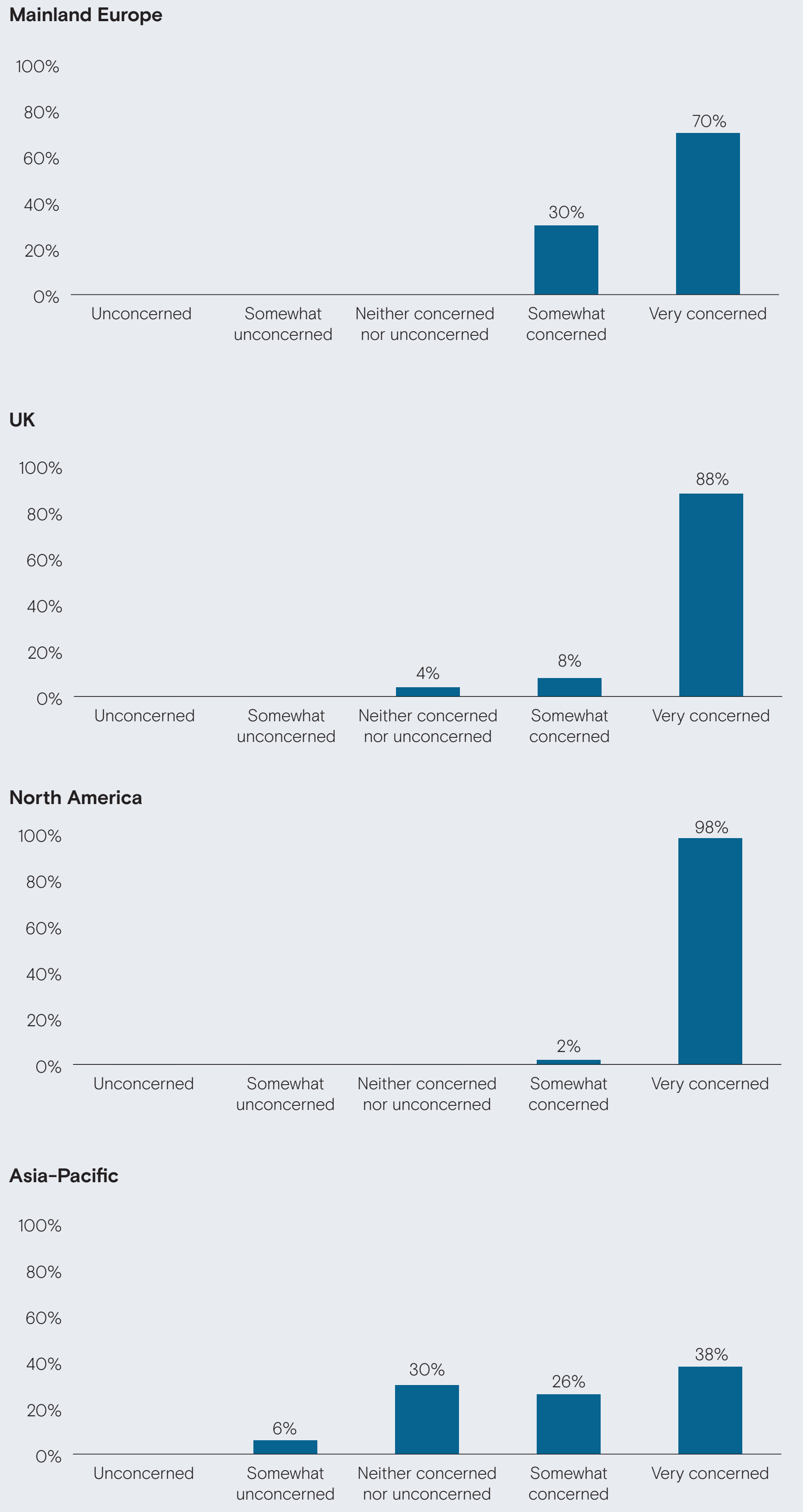
Meet the press

Some types of companies are pegged to attract more attention than others. In this research, the technology, media and telecoms (TMT) sector is seen as a likely centre of activist activity, with 26% of respondents picking it out. With TMT companies continuing to dominate M&A statistics in Europe – and interest in the sector generally soaring given how the pandemic has accelerated digital transformation trends – this seems more than justified.

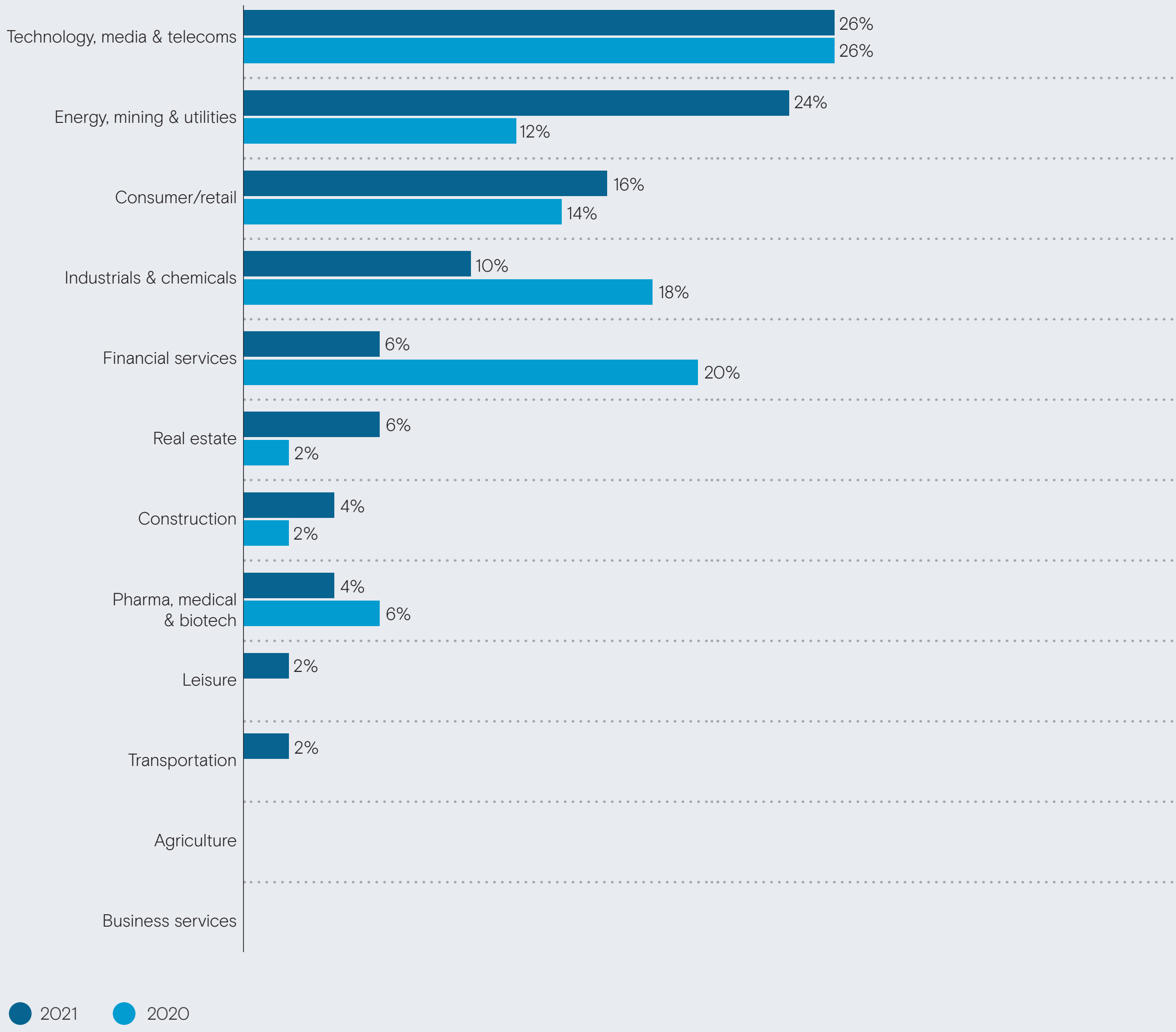
Elsewhere, 24% of respondents think energy, mining & utilties (EMU) companies will be the most popular targets for activists over the next 12 months, up from 12% who made this prediction a year ago. This may reflect the rise in commodity prices recorded in parts of 2021, which has increased the sector's attractions to some investors. Moreover, EMU businesses are a clear focus for investors with ESG considerations in mind, given their enviromental impact.

One question for the year ahead is how the anticipated increase in activism will play out in practice. Corporates are expecting more public confrontations, with 86% agreeing with the suggestion that visible activism will become more prominent in 2022. A corporate board member in Italy puts this down to impatience: "Activists want to see the same financial metrics as in the pre-pandemic era. This will take time to achieve though, with or without their pressure."

To what extent should companies in Europe be concerned about becoming targets from activists based in the following regions over the next 12 months? (Select one option for each stakeholder type)



In Europe, in which industries do you expect to see the most activist campaigns over the next 12 months? (Rank 1 only)

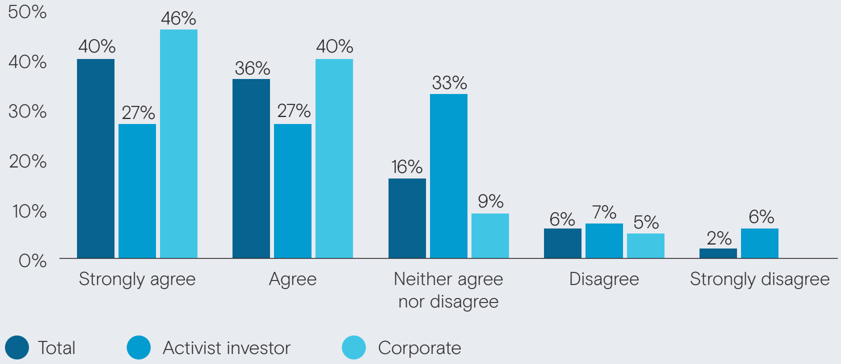


Though many hedge funds pursue activist strategies looking for a quick result, it is not the case that all activists are only focused on short-term returns and so can be assuaged by a one-off distribution. Many are long-term investors, seeking to influence corporate policies now in order to generate a stronger return over the years ahead.

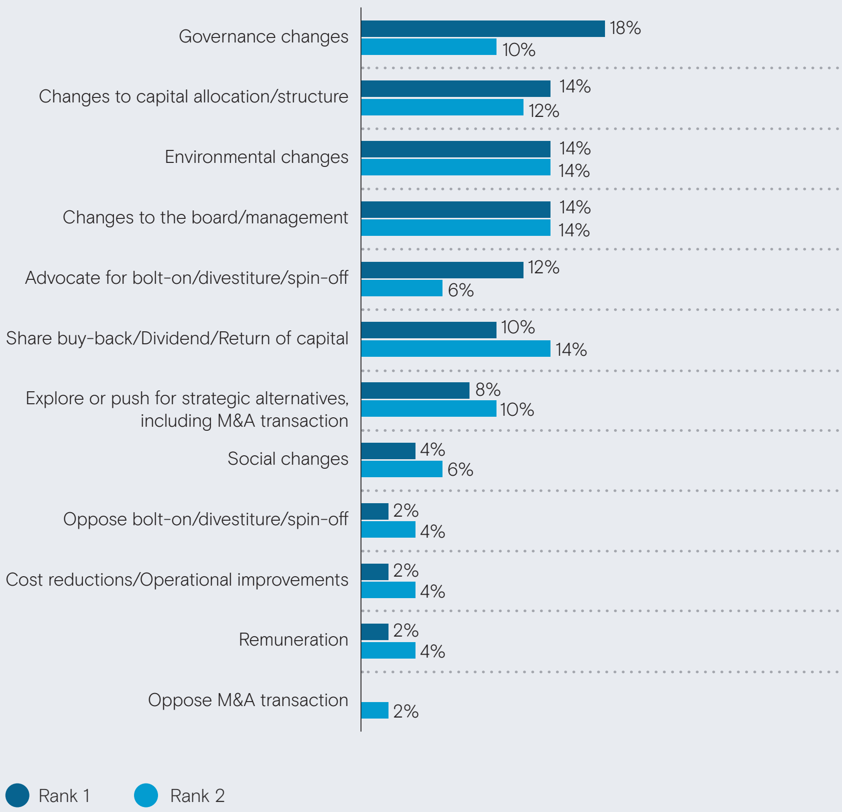
George Knighton, Partner in Skadden's London office

As one French CEO remarks, "Activists are under the impression that companies do not acknowledge the private, confidential format. They feel when they threaten the companies publicly, there will be more positive results in their favour." However, activists do not necessarily agree – while 54% share corporates' view, a significant share (33%) is ambivalent on the subject. "Not all shareholder activism occurs for the same reasons," points out a partner in a UK-based activist investor. "If companies can work closely with shareholders, then public activism will decrease."

Do you agree with the following statement: 'Over the next 12 months, activists in Europe will increasingly employ a strategy of visible, public activism (i.e. public letters, media & campaigns), as opposed to one of private, 'quiet', confidential activism.'?



Of the various categories of activist demands, which of the following do you believe will be the most prevalent in Europe over the next 12 months? (Select top two and rank 1–2)



2 Activists' wish lists

The nature of shareholder activism appears to be changing. While traditional activist causes remain prominent, we are also seeing the rise of campaigns and demands that reflect various aspects of the ESG agenda – and respondents to this research believe this will continue.

In last year's research, just 8% of respondents ranked governance changes – referring to modifications to the underlying rules and practices used to administrate a company – as likely to be the most prevalent type of demand over the subsequent 12 months; for 2022, that number has more than doubled, to 18%. Similarly, while 10% of respondents last year thought environmental issues would be the leading preoccupation of activist investors, this figure is now up to 14%. That puts it on a par today with changes to the board, which was last year's stand-out expected issue, cited by 30% of respondents in the previous edition of this report.

"Activists are going to want to see significant changes in governance structures, including compliance procedures and the way we monitor regulatory systems," predicts the CEO of a UK corporate. In Germany, the CIO of an activist investor says: "Environmental changes will be the most important demand because carbon emission controls will only happen when companies invest in technology and newer assets; it is activists who will compile the proper reports."

A board member of an Italian corporate has already seen this play out, and demands are not limited to the company's internal processes: "Activism related to the environment has increased. Activists are demanding more green initiatives and that our associations with third-party companies be limited based according to their green credentials."

Seats at the table

This is not to suggest activists are losing interest in non-ESG issues, with 14% of respondents still predicting that board changes will be the most common demand over the next 12 months.

For some shareholders, patience is running thin – 20% of respondents think activists are most likely to seek board changes because they are not earning the returns they expect. As the managing partner of an activist investor in the UK says: "When the board members are not providing any positive results, it does not make sense to continue with the same composition." Similarly, 16% think activists are most likely to push for board changes in order to bring in new expertise.

Most obviously, 14% of respondents think the primary motivation of activists pushing for board changes will be anxiety about a perceived lack of board independence (linked to the 18% of respondents who cite a desire to increase representation of minority shareholders).

Moreover, in last year's survey, 7% of respondents mentioned lack of diversity as likely to be the main motivation for activists making demands regarding changes to the board; this year, that figure has increased to 10%, with a further 16% suggesting it will be the number-two issue.

The notion that activist investors are focusing on a broader set of issues is also evidenced by the declining number of respondents who believe that dividends and share buy-backs are likely to be key near-term battleground issues. While 42% do still strongly agree with the suggestion that this will be a significant focus for activists over the next 12 months, that number is down significantly from last year's figure of 66%.

This may reflect changing market dynamics. A year ago, Europe was in the middle of a dividends crisis, with companies slashing pay-outs during the pandemic. Activists were understandably anxious about their slowing income streams, but one year on, corporate dividends have moved into recovery mode.

However, some activist respondents simply deny the point that most activists are more interested in capital or income distributions than in other issues. "The issue of share buy-backs isn't high on activists' lists," says the CEO of one activist. "Activists might think about selling if the amount is right and they want to divest, but the situation is different for all activists in this regard." The managing partner of another activist tempers: "There are other issues that activists will pursue besides share buy-backs – it will be crucial for companies to set up their ESG goals based on the latest market trends."

Getting green fingers

In this context, nearly two-thirds of respondents overall (62%) believe activists will increasingly prioritise ESG issues in their campaigns. And at a more granular level, the data contains a warning sign for corporates and their boards.

While 26% of corporate respondents strongly agree with this projection, amongst activists themselves, the figure is 80%. In other words, activists' determination to capitalise on ESG issues in their campaigns is much higher than many boards consider.

> Even corporates with exceptional governance and social standing cannot expect to be spared. Today's ESG standards, whether in regulation or public opinion, are significantly broader than in the past. New legislation relating to supply chain responsibility, to give just one example, adds to uncertainty, and its effects are not limited to regulatory compliance.
>
> Matthias Horbach, Head of Skadden's German M&A practice

Some corporates tend to recognise what is coming. In Italy, one board member says: "We will be holding talks with shareholders about our net-zero carbon emission plans. The focus on the environmental issues has increased and we want to ensure that all stakeholders are on the same page." In Germany, a COO adds: "With the unpredictable climate conditions that we're facing today, the process for lowering our carbon footprint is being discussed."

The managing partner of a Swiss activist investor warns: "Investors don't want to be associated with companies that lack a strong ESG perception – they know their reputation is also at stake if the company decides to invest in an energy-intensive project." Similarly, the managing partner of a UK investor argues: "ESG issues will have a profound impact on investor sentiment. Investors want more disclosures on ESG topics, so companies need to prepare their resources for this." Corporates may want to reconsider their views on activists' focus on ESG issues.

New disclosure strains

The bottom line is that ESG issues have the potential to become a significant flashpoint for confrontation with activists. With most European businesses facing increased reporting and disclosure requirements from both national and supranational regulators, there will be additional material in the public domain to fuel such clashes.

So far, ESG disclosures have been rather heterogenous and, in part, not very meaningful. But this will change, and activists will further scrutinise ESG reporting to find angles for value creation.

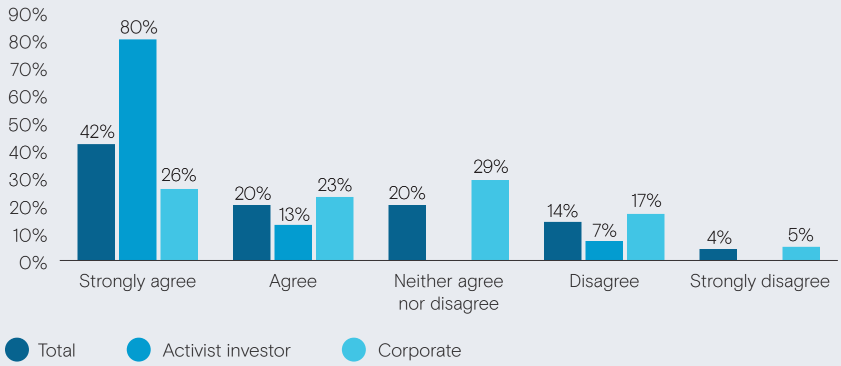
Holger Hofmeister, Partner in Skadden's Frankfurt office

Activists see the potential here. Half say ESG disclosure requirements will have a significantly increased impact on activists' demands, with a further 20% anticipating a moderate impact. Companies themselves are less convinced that their disclosures will have this effect, suggesting that some may be in for unexpected demands. But directors of these corporates should be under no illusions.

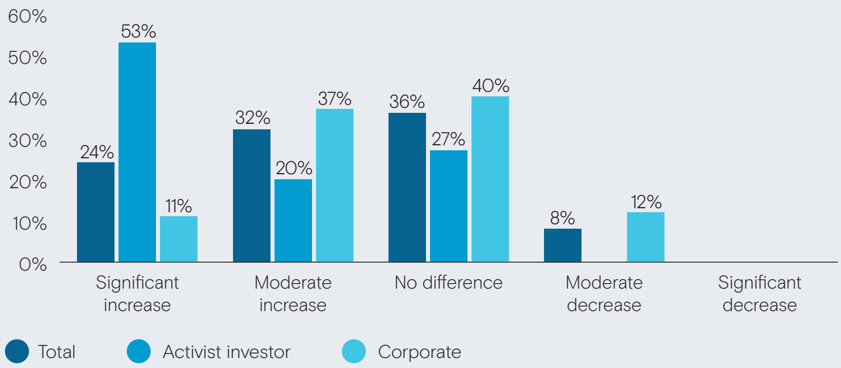
"Investors will evaluate the capacity of companies critically in the next 12 months," says the CEO of an Italian activist investor. "The enhanced ESG reporting structure will give them the confidence to demand changes where they feel it is required." At a UK activist, a partner argues: "Investors have always pushed for higher ESG disclosures, which the companies have not provided, but now that it has become mandatory, the demands are also likely to increase."

A board member of a German corporate believes the path is clear: "There will be an increase in ESG-related demands because the activists now have concrete information about ESG metrics and the major risks."

To what extent do you agree with the following statement: 'Activists will increasingly prioritise environmental, social and governance (ESG) issues in their campaign demands.'? (Select one)



What impact do you believe ESG disclosure requirements will have on activists' demands over the next 12 months? (Select one)



A well-prepared board is key for a successful defence. However, when things go public, the board must react quickly, remain firm and be ready to strike back. If activists go public, it is rarely to have a friendly talk.

Armand Grumberg, Head of Skadden's European M&A practice

3 Boards' best defences

Amid this expected swell in activism, every board must consider how it will respond. And in practice, many respondents to this research believe there is scope to use a broad range of tools and tactics to alleviate the danger of activist campaigns.

Part of the response will be to continue engaging with investors; as we have already noted, in some cases corporates are even proactively broaching perceived weaknesses with shareholders long before they can be raised by activists.

That may not always be appropriate, but 23% of corporates surveyed – and 27% of activists – do think frequent engagement with advisers in a position to evaluate shareholder sentiment and identify investor concerns is an important part of the response to activism. "Advisers can lower the burden on internal teams – they have access to relevant information that can be trusted," says a director of a corporate in the UK.

Among corporates, the next most popular mitigation strategy cited by respondents (20%) is to focus on maintaining transparent disclosure practices. But if board members think good reporting, in itself, will be enough to keep the activists at bay, they may be disappointed; only 13% of activists think this is an effective preventative measure.

Instead, activists are looking for corporates to really get to grip with their needs – and to identify where the business needs to work hardest to resolve weaknesses. In addition to engaging with advisers, more than a quarter of activists surveyed (27%) suggest commissioning director analyses; only 6% of corporates agree. "A director vulnerability analysis would make their position crystal clear to the company," says the CEO of a UK-based activist investor. "They can fix the issues that have been highlighted before shareholders point them out either publicly or privately."

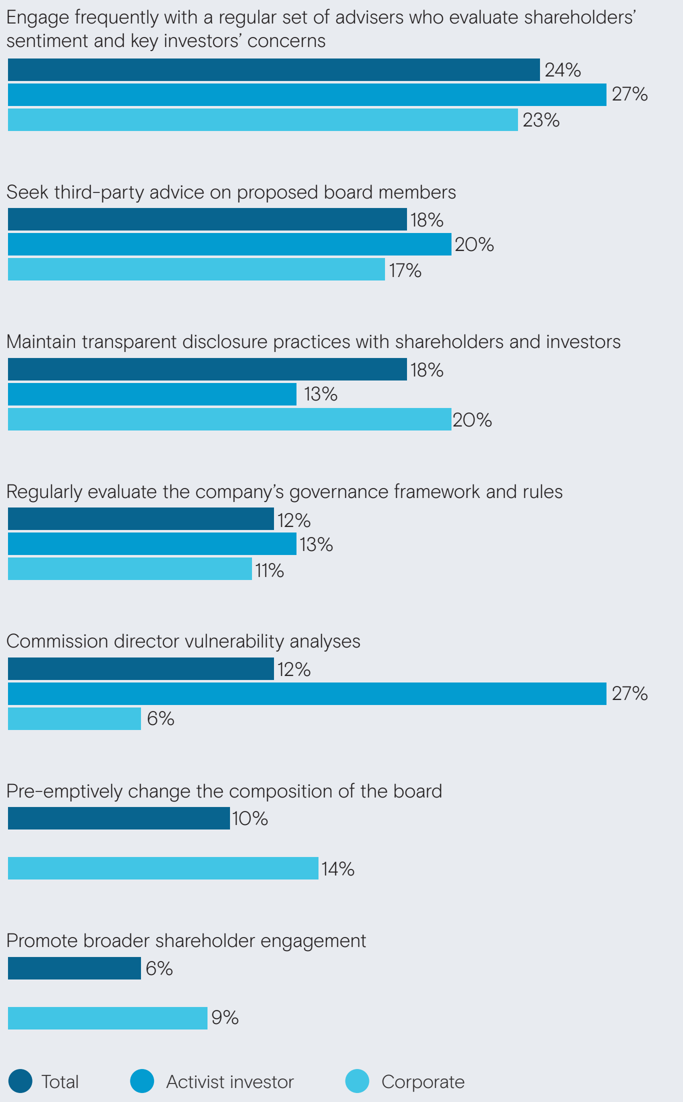
Strengthen your mettle

Still, whatever preventative measures corporates seek to take, there will be times when activists nonetheless opt for public campaigns. In which case, boards must think about how to defend the business when the situation escalates and tempers fray publicly.

Here too, activists and corporates take diverging views on the best way forward. In the latter's case, many companies hope, even after a campaign has been launched, that communication can resolve the issue. A third (34%) see investor engagement as an effective defence tactic, while 23% think talking to the activist could be crucial.

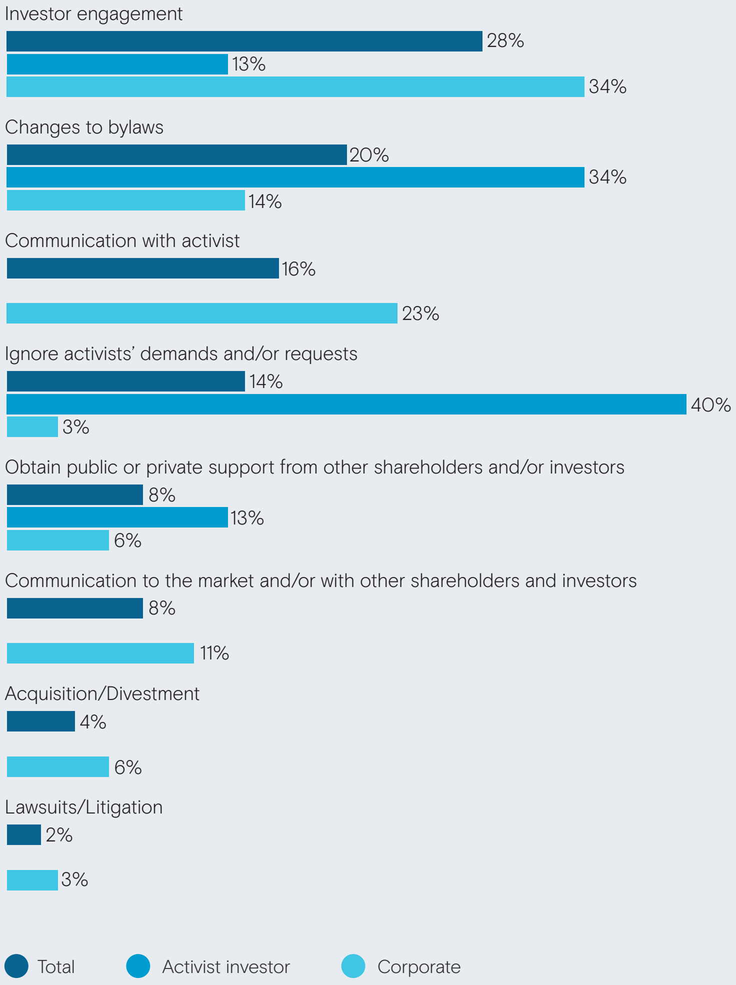
Activists, by contrast, indicate the time for talking may be over at this stage. Only 13% advocate long-term investor engagement, and none think talking with them directly would be a useful defensive tactic.

In your view, what are the most effective preventative measures that companies can use to mitigate the chances of activist campaigns? (Most important)



> Sophisticated activists have had success in rallying institutional investors to their cause. Company boards, too, seem more open now to engaging in an initial dialogue with activists.
>
> Arash Attar-Rezvani, Partner in Skadden's Paris office

What are the most effective defensive tactics that companies use when faced with a public activist campaign? (Most important)



Instead, their advice is simply to ignore their demands (40% of activists suggest this) or to make changes to the company's bylaws as part of the defence (34%).

In other words, while corporates believe taking a delicate approach to confrontation will be effective, activists, were they in boards' shoes, would be more inclined to adopt a more steely manner.

Ingratiating yourself to institutional investors

One issue for boards to consider during a confrontation with activists is which constituencies might offer support. This research suggests different groups of stakeholders are expected to take different views of activists' public campaigns.

For example, boards may feel that they will find little support from their broader institutional investor shareholder base, given that 96% of respondents believe these investors are likely to be at least somewhat accepting of activists (only 36% took this view in last year's research). Retail investors, by contrast, are expected to see confrontations differently, with only 34% of respondents believing this group will be accepting of activist campaigns.

Interestingly, boards themselves are not necessarily expected to be hostile to activist campaigns. Only 24% of respondents say boards will be very intolerant of activists over the next 12 months. Nor are management teams regarded as automatically hostile; indeed, 64% predict they will be open-minded. On this basis, boards facing a public campaign from an activist should not make assumptions about where stakeholders' sympathies lie.

Still, while institutional investors are not seen as automatic allies for the board in the event of a public campaign, there is a consensus that increased engagement with these investors could help squeeze activists out of the picture. After all, where companies have built strong relationships with their largest shareholders, the ability of an activist to campaign effectively for change, which will require broad investor support, is likely to be more limited.

> For corporates, keeping shareholders on board with your strategy not only reduces the likelihood that they will be swayed by activists, but it also helps keep stock prices up – which ultimately is the best protection against activism.

Scott Hopkins, Co-Head of Skadden's London M&A group

In this context, 62% of respondents agree with the idea that increased engagement between companies and their institutional shareholders will diminish the role of activists. Tellingly, that number rises to 80% amongst activists themselves, suggesting they are aware that closer relationships between companies and their biggest shareholders will leave them with little room for manoeuvre.

"The large, institutional investors are more influential, and companies do benefit from being associated with them," concedes the managing partner of an activist investor in Switzerland. "No company would want to lose those investors; they will find that engagement helps to a great extent in creating value for shareholders."

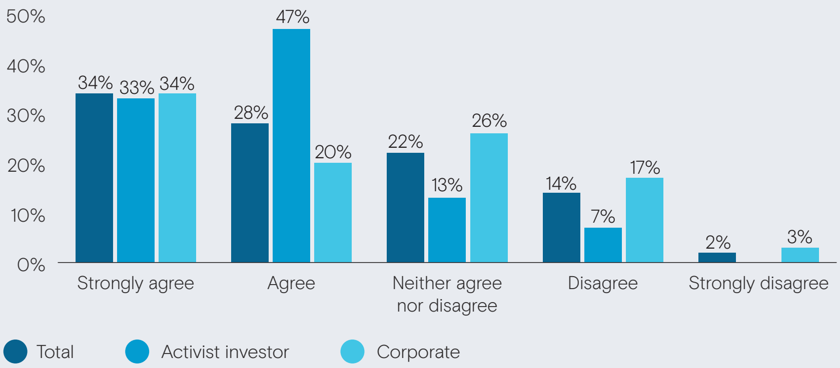
Indeed, more corporates may need to follow the advice of the board member of an Italian corporate, who points out: "When the key concerns of institutional investors are understood and dealt with proactively, there will be fewer topics for activists to be aggressive about."

Ultimately though, these sorts of tactics mean little if the results do not meet expectations. Convening for convening's sake is insufficient. As the board member of a UK corporate says, "We cannot confirm that engagement alone will decrease the number of activist investors. Unless the engagement brings forth some positive changes in the organisation, it would be considered futile."

Over the next 12 months, how accepting or intolerant do you believe the following stakeholders will be of activist investors and public campaigns?

Boards of directors	2021	2020	Difference
Very intolerant	24%	28%	-4%
Somewhat intolerant	16%	8%	8%
Neutral	42%	16%	26%
Somewhat accepting	14%	42%	-28%
Very accepting	4%	6%	-2%
Management teams	**2021**	**2020**	**Difference**
Very intolerant	2%	8%	-6%
Somewhat intolerant	10%	28%	-18%
Neutral	24%	30%	-6%
Somewhat accepting	44%	28%	16%
Very accepting	20%	6%	14%
Institutional investors	**2021**	**2020**	**Difference**
Very intolerant	0%	8%	-8%
Somewhat intolerant	0%	34%	-34%
Neutral	4%	22%	-18%
Somewhat accepting	36%	34%	2%
Very accepting	60%	2%	58%
Retail investors	**2021**	**2020**	**Difference**
Very intolerant	2%	0%	2%
Somewhat intolerant	18%	10%	8%
Neutral	46%	32%	14%
Somewhat accepting	28%	50%	-22%
Very accepting	6%	8%	-2%
Sell-side analysts	**2021**	**2020**	**Difference**
Very intolerant	6%	0%	6%
Somewhat intolerant	24%	18%	6%
Neutral	38%	62%	-24%
Somewhat accepting	32%	20%	12%
Very accepting	0%	6%	-6%

Do you agree with the following statement: 'Increasing engagement between large, institutional investors and the companies in which they control major shareholdings will greatly diminish the role of activist investors.' (Select one)



4 How best to calibrate the balance of power

With activists preparing to launch further campaigns, and corporates braced to defend themselves, there is anxiety on both sides about the ability of the other to frustrate their objectives. Among both activists and corporates, a clear majority believes the opponent starts with the upper hand in any confrontation.

If anything, this difference of opinion is becoming more polarised. Most corporates (74%) complain that the balance of power is skewed towards the activists; in last year's edition of this research, only 69% felt this way. Similarly, 67% of activists believe the balance of power benefits the corporates, up from 47% last year.

The more sober assessment is that power is typically more finely balanced. There may be shifts in that balance over time – increased ESG disclosure requirements, for example, or growing retail investor intolerance of activists – but, in the end, each confrontation is an individual situation with its own nuances. Indeed, 22% of respondents concede that the balance of power is more or less equal.

Empowering the powers that be

Naturally, given their diverging objectives, activists and corporates take contrasting views about how the legal framework around public campaigns should evolve.

> One area on which most long-term shareholders agree is that the activists should have the same level of 'skin in the game', through holding their interest in ordinary equity, as longer-term shareholders.
>
> Bruce Embley, Partner in Skadden's London office

There is at least some agreement on misleading information, with 20% of respondents on each side citing the need to extend the scope of rules governing false or misleading information provisions. "These can have a negative effect for all stakeholders," says the CEO of a French corporate. "Public campaigns should be based on accurate information that is derived from reliable sources." Beyond that consensus, however, the two sides' views on what else is needed differ markedly.

For corporates, the clear preference is for greater legal and regulatory protection from activists: 20% of corporate respondents believe the number one area of focus should be giving financial market authorities more powers to intervene in confrontations. Only 7% of activists say this is necessary or desirable.

"There is already power for financial market authorities, but this is not enough – they should be able to exercise more control to avoid monopolistic or activist behaviour at the same time," argues the CFO of a German corporate. The CEO of a Swiss business adds: "The financial market authorities could put a stop to unnecessary public campaigns; the image of companies would then not be affected unless there is a genuine reason for a campaign."

Similarly, 17% of corporates argue in favour of extending the black-out period to activists as a top priority. Not being subject to the same rules on when shares can be traded, typically around earnings announcements, puts activist investors at an unfair advantage, corporates argue, though only 7% of activists agree.

Among activists, by contrast, the most common top demand is for the creation of some form of shareholder dialogue platform within each company, highlighted by 27% of these respondents (but only 9% of corporates). "A lot of information can be shared on such a platform – there will be a higher degree of transparency within the organisation and with its shareholders," points out the CEO of a UK-based activist investor. "With a shareholder dialogue platform, the shareholder can provide new insights on a regular basis; there should be a dedicated team to address the key issues that have been posted by shareholders," another UK-based activist adds.

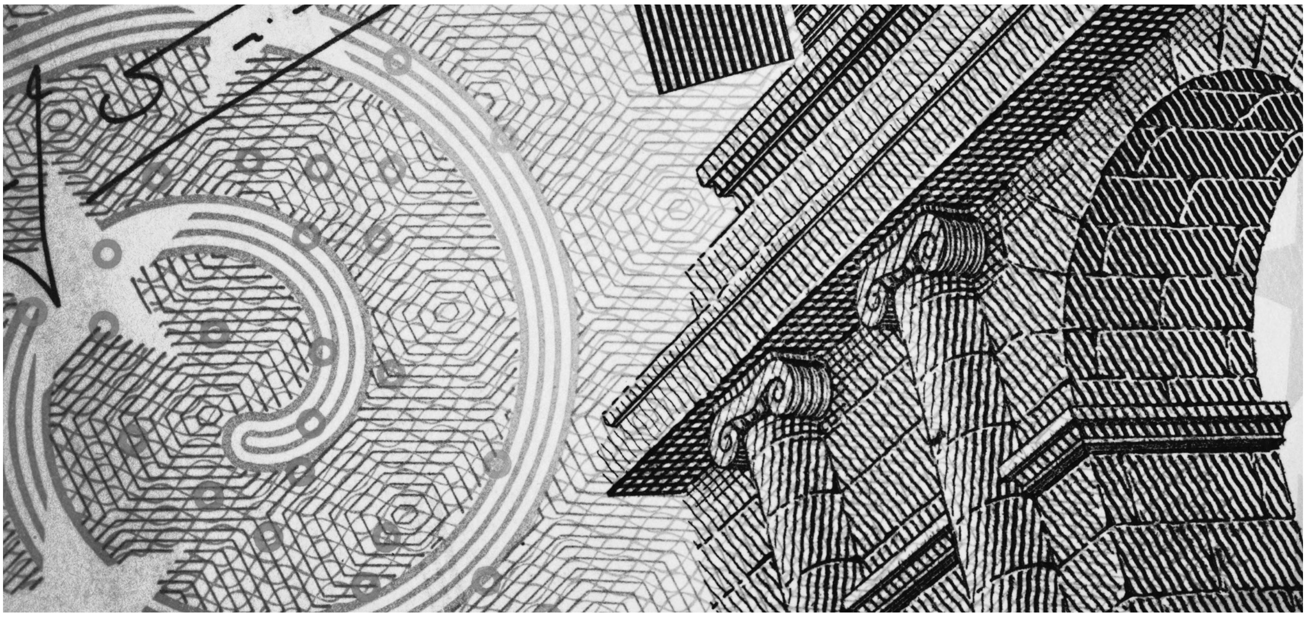
Activists are also more likely to suggest mandating a period of dialogue between activist and company prior to the launch of a public campaign as a priority – 13% agree, as do 11% of corporates. Similarly, 13% of activists want to see a reduction in the threshold at which shareholdings must be disclosed as the top priority, but only 9% of corporates agree with that notion.

Finetuning the legal framework

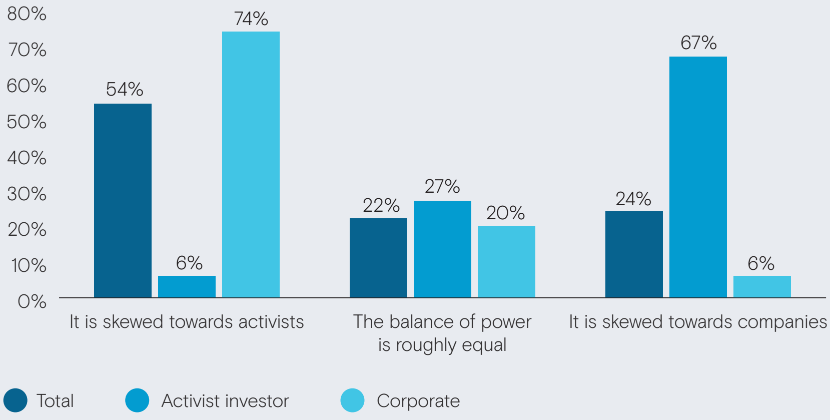
The reality is that reconciling the differences between corporates and activists will be tremendously difficult. Both sides are keen to resolve what they perceive to be inequalities in the current system, and to undo some of the advantages they believe their opponents hold. But with such polarised views on what is needed, a consensus will be hard to reach.

> Misleading information continues to be an important consideration, but legislators are uncertain on how best to address the problem. They largely defer to financial regulators and have strengthened their rights to intervene. So far, the defence against misleading information from activists remains limited to the application of general principles of law and existing regulation on market abuse.

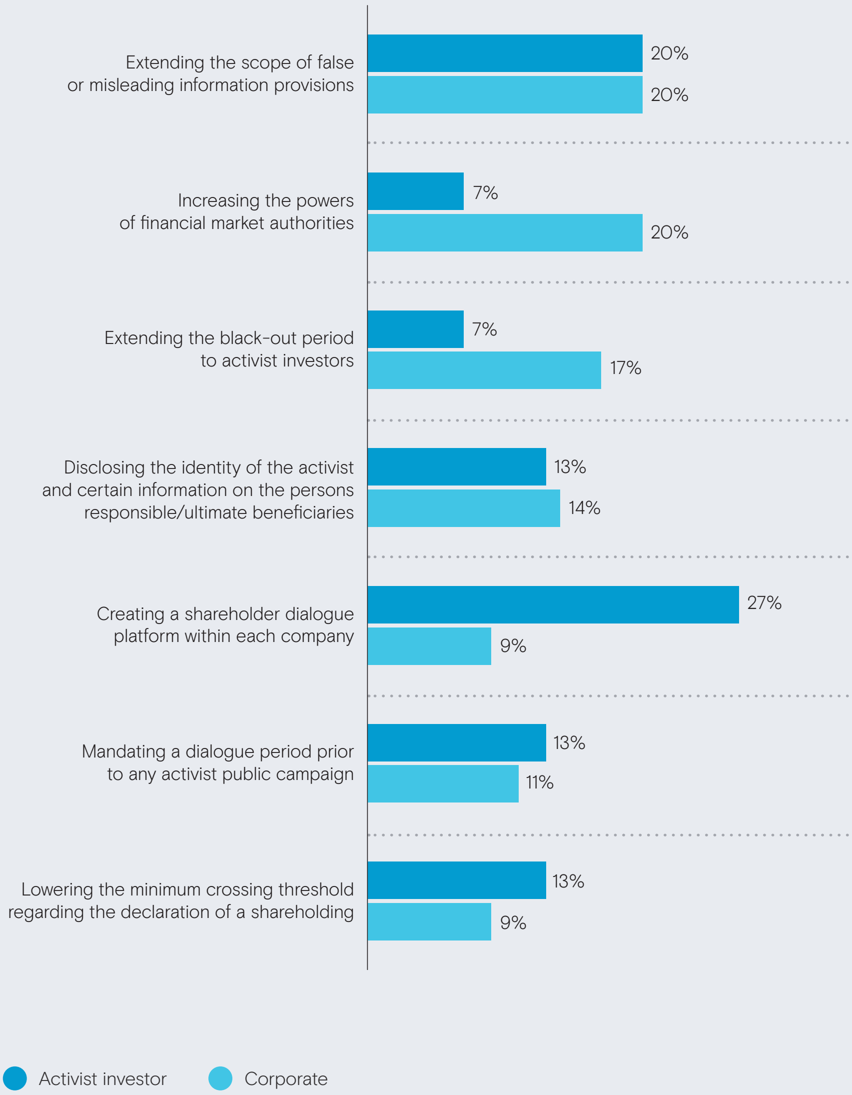
Matthias Horbach, Head of Skadden's German M&A practice



Regarding the 'balance of power' between activists and companies, do you think it is roughly equal, or skewed more towards one side? (Select one)



On which area do you believe the evolution of the legal framework should focus with respect to activist investors and public campaigns? (Select one)



For policymakers and financial regulators, the question is whether the current system is fit for purpose. With investor activism increasing, do the current checks and balances give both sides – and the broader groups of stakeholders who get caught up in public campaigns – the necessary protections? At the very least, given the agreement between activists and corporates on the problem of misleading information, is there now a case for new rules in this area?

This will be an ongoing debate. With regulators understandably focused on the turmoil roused by the pandemic, including the substantial market disruption and volatility the virus has engendered, there has been little appetite to undertake new reviews and reforms in other areas. As the pressures of the pandemic ease, however, that may change – and both activists and corporates will want to make their case.

Other jurisdictions are now focusing on activists. In the US, for example, the Securities and Exchange Commission introduced new regulations in November 2021, with fillips for both sides – analysts believe the changes may make it easier for activists to gain a foothold in the boardroom, but harder for them to actually assume board control. Europe may soon find it suitable to follow suit.

Lessons to live by in 2022

While shareholders may have been prepared to give boards the benefit of the doubt at the height of the crisis, their tolerance for companies failing to bounce back or show the agility required to deal with the challenges of Covid-19 is shrinking. Moreover, the pandemic has undoubtedly accentuated corporates' underlying vulnerabilities, providing activists with clear points of attack.

At the same time, the momentum of the ESG movement looks unassailable, particularly given the increasing amount of regulation requiring companies to make more disclosures of their performance in key areas. There will be no hiding place for boards that are falling short on key ESG matters – and they should expect activists to capitalise. In the words of a UK-based managing partner of an activist investor, "Companies are not being serious about their ESG goals. They think about it as if it were just 'something extra' to tick off on a list."

With so much at stake, every board should be thinking about the potential for activist investors to target their company – not simply because such confrontations can be bruising and disruptive, but also because they very often reflect broader concerns that may be to the detriment of all stakeholders. As one partner of a UK-based activist investor puts it, "Companies must realise the significance of engaging with their shareholder audiences. They cannot afford to be aloof."

Boards that know their investors well will understand their concerns and be better placed to respond. They will also find more support if an activist does make waves. Building a constructive dialogue with a wide range of shareholders has never been more important.

The key will be to think not only in terms of what is necessary to head off confrontation – certainly, there is a place for mitigating risk and adopting preventative measures – but studying the activist threat also provides an opportunity to reassess where the business now stands, and where its ambitions should now lie.

As companies across Europe seek to build back better from the Covid-19 crisis, this is work they should be undertaking in any case, even without the activist-shaped spur to self-appraisal. Better managed businesses with newly demanding and relevant targets will deliver superior performance for all shareholders, leaving activists with nothing of substance to complain about.

> Public campaigns are just the tip of the iceberg. With institutional investors more receptive to activist demands, there is a strong likelihood that companies will face mounting pressure in 2022.

Armand Grumberg, Head of Skadden's European M&A practice

Key takeaways:

1. Bridge the gap with large shareholders. Especially in the context of the pandemic, institutional investors should be forgiven their fair share of anxieties. Questions abound, and the prudent board members would do well to answer them before they themselves are questioned or approached by activists. Purposeful disclosures and close engagement with influential institutional investors are crucial.

2. Talk it out among trusted advisers. With the help of a select team, a board can both gather valuable insights into investor sentiment, make sure shareholders feel heard and prepare for any activist actions. If and when approached by activists, companies should consider not immediately closing the door.

3. Expect more public campaigns, but don't be afraid. If a public campaign does arise, then the usefulness of the talking cure may have run its course: to the extent necessary to protect the issuer and the stakeholders' interest, ignoring activists' demands is a way to go, while always maintaining a strong dialogue with institutional investors.

4. 'Green is good', a latter-day Gordon Gekko might declare. Activists are evidently preparing to make use of new ESG disclosure requirements to further their interests and ask fresh and additional questions to boards. It is crucial that companies get and stay ahead of the curve on ESG, as is already the case for governance. Aside from the real-world benefits, doing so will assuredly give companies a competitive advantage, and avoid some hustle and bustle from activists.

About Skadden

Skadden is a global leader among law firms involved in mergers and acquisitions and other corporate transactions, and a top adviser for clients on corporate governance, takeover preparedness, contests for corporate control, proxy fights, and other forms of shareholder activism defense. We provide clients with an integrated team from different areas of law, including attorneys from our M&A, corporate governance, and litigation practices. Our diversity of experience helps clients address the full spectrum of issues presented by activists and is key to helping our clients prepare for and respond to activist shareholders advocating strategic, financial, or structural changes.

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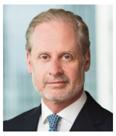

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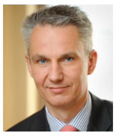

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Activistmonitor delivers a unique combination of in-depth reporting and historical analysis on key activist campaigns for advisors and the investment community. Our quick and comprehensive news service provides the backbone for analytical tools which allow you to anticipate the next move in an activist campaign or generate new business ideas based on active investing trends in the marketplace.

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