

Unwanted Mail: How Companies Should Deal with Activist Investors

Activist investors are increasingly putting pressure on companies with their demands. Ignoring them is not an option. Instead, companies should adopt the perspective of activists to make themselves resilient and sustainably increase corporate value. Professional capital market communication plays a crucial role in this process.

The trouble often announces itself through a letter. Activist investors express their dissatisfaction with the business performance of the contacted company in these letters and present their concerns. They may demand actions such as the spin-off or sale of a business unit, a strategic change in direction, or changes in leadership. Sometimes, there's no explicit investment approach, and it's about exploiting a perceived undervaluation of the company. However, the motivation behind it is always the same: to generate the highest possible return. This, however, is not always aligned with the goals of the targeted company.

Extensive Preparation

Writing to the top management of a company is often just one part of an investor campaign, supported by external public opinion campaigns and increasingly digital channels. The open letter almost always has a backstory: the majority of activist investors follow a well-thought-out investment strategy. This strategy is based on months of preparation, analysis, and numerous conversations with market participants aimed at identifying weaknesses in the potential target company and ultimately putting pressure on management. This results in an action plan with numerous demands, while simultaneously building positions in the identified company.

While activist investors were predominantly active in the United States for a long time, European companies are also increasingly coming under the scrutiny of activists. The consulting firm Alvarez & Marsal expects more campaigns in Switzerland in the next twelve months. In many cases, the management's reaction to discussions with investors determines whether a campaign will take place. If the investors' concerns are deemed practical, the process may proceed behind the scenes without public involvement. Activist investors do not always face rejection; often, they highlight optimization potential and value enhancement opportunities in the company, ultimately pleasing institutional and private investors.

Effective Capital Market Communication is Crucial

How can companies prepare for potential moves by activist investors? The company's management should regularly review the strategy and common concerns of investors regarding their own company to minimize potential vulnerabilities. The focus is on the stock market valuation. If the company's valuation

is adequate or even high, it discourages activists. They often enter when stock prices are generally low, aiming to capture future gains.

At this point, professional capital market communication plays a crucial role, especially before a potential involvement of an activist investor in the company. It helps to communicate the equity story comprehensibly in the market. Investors need to know the opportunities and perspectives the company offers. The equity story should undergo regular stress tests and be checked for potential inconsistencies that could cause uncertainty among market participants. The same applies to financial goals: companies should clearly state their goals and support them with metrics and measures. They should ensure that the goals are clear and realistic to increase shareholder value. By focusing on optimizing the strategy and achieving long-term goals, companies can simultaneously reduce potential points of attack for activists and increase their attractiveness to potential investors.

An effective way to strengthen a company's resilience against activist investors is to improve the governance structure. This includes establishing an independent board of directors, strengthening internal controls, and creating transparent decision-making processes. A solid governance structure can help protect the company's strategy and gain the trust of investors.

Prepare in Good Times

Equally important is regular communication with core investors. Publicly traded companies often neglect communication with relevant shareholders in quiet times. They should continuously inform about their strategy, progress, and long-term plans. By building a good relationship with core shareholders, companies can present their perspective, gain their trust, and minimize potential conflicts. At the same time, any concerns raised by shareholders can be taken in as an early warning system and processed within the company.

The same principle applies to the media: building and maintaining a solid relationship with relevant media is key to presenting the company's positions credibly and comprehensively, should an activist cause unrest with their demands. Without such a network, a crucial channel is missing in a challenging situation for the company.

Analyze, Constrain, Communicate

Careful prevention and effective capital market communication can protect companies from the intentions of activist investors. Unfortunately, this is not always the case. Here are some recommendations for companies that have received an open letter from an activist investor with their demands:

- Thorough Analysis:
 - Carefully analyze the intentions of the activist investor.
 - Examine the motives and track record of the investor for a better understanding of their goals.
 - Based on this analysis, develop an appropriate and coordinated response.

- Constraint:
 - Conduct negotiations preferably behind closed doors.
 - Selective appearance in the (media) public.

- Seriousness:
 - Take expressed criticism seriously and assess potential consequences.
 - Respond to the received letter in a suitable manner within a useful timeframe.

- Issue Management:
 - Establish a crisis team chaired by the chairman of the board of directors, including financial and communication advisors.
 - Monitor the activist and their next steps closely.

- Communication:
 - Develop a narrative with counterarguments.
 - Maintain close communication with all core shareholders, including the activist.
 - Hold personal meetings with key media/journalists.

Facing activist investors can be a challenge for companies. Nevertheless, companies should consider this situation as an opportunity to strengthen their governance structure, improve performance, and intensify dialogue with all stakeholders. In the event of an attack by an activist investor, companies should respond with a thorough analysis, a smart reaction, and open communication. In such a case, it is essential to remain calm, examine the expressed criticism seriously, and maintain constant communication with all core stakeholders, including the activist investor. Convincing responses or plans from the company can also win over activists.