By Gustave Laurent & Martin Stone

# The Gloves Are Coming Off as Shareholder Activists Look Towards Europe: How Companies Can Prepare to Fight Back

While shareholder activism has historically been a US affair, it is starting to put down deep roots in Europe. In recent years, hedge funds' underperformance relative to equities, combined with their contested fee structure and institutional investors' increasing acceptance for activists, have led to a boom in activist campaigns. Europe is no exception: in the last year, German engineering group Thyssenkrupp, French beverage company Pernod Ricard, and British amusement park operator Merlin Entertainments have all come under pressure from shareholder activists. While activist investors have tended to take a more constructive approach when engaging with European corporates, it may not be long before more outspoken and confrontational US-style tactics cross the Atlantic.

The number of activist campaigns against European companies tripled between 2014 and 2018, with demands relating to M&A—such as calls for the sale of an underperforming business division or opposition to a proposed transaction—being a significant component of these campaigns. Activism in the region looks set to grow, due in part to the expectation of increased M&A activity in the years ahead.

So far, US hedge funds have taken a conciliatory line in Europe, positioning themselves as "constructivists" rather than activists to avoid alienating company investors. A key reason: share ownership in Europe is concentrated in the hands of long-only institutional investors whose preferred tactics are behind-the-scenes engagement with management. However, attitudes among European institutions have hardened in recent years. Since the euro and global financial crises of 2009, they have become less tolerant of underperforming companies. That said, activists' use of the media or damaging information about sexist practices and inappropriate behaviour—which are increasingly commonplace in the US in the wake of the #MeToo campaign—are still unacceptable in Europe, at least for now.

But European institutional investors are more likely to view activists as precious allies who can be more outspoken in pushing for change than they can, and they are more willing to support giving an activist investor a seat on the board. As a result, proxy battles, which are common occurrences in the US, are very rare in Europe.

Target companies in Europe have also woken up to the fact that activists are a force to be reckoned with and, in contrast to many American companies, are engaging with activists early in the process in an attempt to defuse potential conflicts. Because companies are more ready to listen, US activists are choosing dialogue over hostile diatribes. However, this state of affairs is unlikely to continue. With foreign ownership of European and UK companies set to increase and a difficult macroeconomic environment, shareholder activism in Europe is highly likely to continue to grow, both in volume and noise, representing a new type of challenge to corporates. With that in mind, companies should consider identifying, and taking steps to address, their vulnerabilities to head off potential activist campaigns before they emerge. Subjecting themselves to different mock activist scenarios can be a particularly effective way for companies to learn about their weaknesses—whether it relates to executive compensation, board composition, or their M&A strategy—and prepare an appropriate response.

At the same time, companies that could become activist targets are well–advised to "know their enemy." Understanding an activist's investment style, track record, tactics, and vulnerabilities can assist a target company in evaluating its course of action. For example, in a proxy battle, being able to discredit the qualifications of a proposed board member, will, by extension, call into the question the credibility of the entire proposed slate. In addition, the examination of an activist's track record may identify patterns of working with certain parties (*e.g.*, other activists, journalists, research firms) that could be relevant to a company's current situation.

As shareholder activism continues its expansion across Europe, companies that take these steps will strengthen their defences should they become an activist target.

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