



Whose culture is it anyway?

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Paul Moxey

The changing face of activism

'In preparation for future campaigns, many activist investors are coming to London to engage in "Listening Campaigns" with many of the long-only, household name investors. Clearly the activist will have their own views on their specific target but instead of launching into their own discourse, they are more interested in hearing what other shareholders in the target view the company in question.'

Cas Sydorowitz

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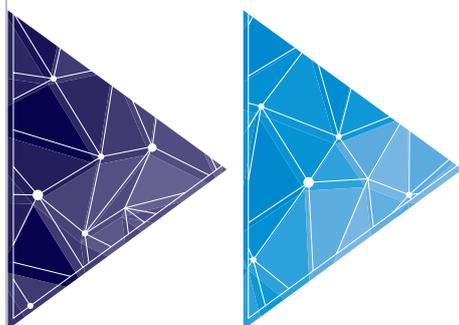
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News

2015 UK Board Index

Spencer Stuart, one of the world's leading executive search consulting firms, has recently published its *2015 UK Board Index*, a comprehensive review of governance practice in the largest 150 companies in the FTSE rankings, providing a valuable indication of the state of boardroom health during 2014–2015.

Female and foreign

Forty per cent of women on the boards of the top 150 UK listed companies are non-British nationals, compared with 30 per cent of men. Besides being an indication of the importance of international talent to the UK economy, it demonstrates that boards are casting an increasingly wide net to find women with the requisite experience. Most FTSE 150 companies have an international footprint and finding directors with experience in strategic overseas markets can be critical.

First-time directors

In the quest for new skills and more diverse membership, companies remain open to appointing directors who have not previously sat on a listed company board. 31.6 per cent of newly appointed directors were first-timers, compared with 31 per cent in 2014, evidence that UK boards are being refreshed at a steady pace and that listed board experience is not the priority that it used to be for nomination committees. Following the financial crisis fewer senior executives were encouraged to sit on outside boards, but that trend seems to be reversing. 47.4 per cent of all new directors were active executives (as opposed to portfolio directors) and among first-time directors 67.8 per cent were active executives.

Female chairmen

The number of female chairmen (all but one refer to themselves as chairman) has never been higher. There are now six women chairing FTSE 150 companies compared to just two years ago when there were only two among the top 150 companies. Several of the chairmen are former CEOs, though not of listed companies, and all but one of the chairmen have a banking/financial services background.

Non-executive director fees

The average total fees for non-executive directors in the top 150 companies is £88,100; excluding senior independent directors the average is £82,002. This includes the retainer, committee fees and attendance fees (where paid). Whilst comparing favourably with the Netherlands, Italy and France, this is lower than the total fees paid to directors in Spain, Germany and the US. The average retainer paid to non-executives is £63,229. Whereas the total fees paid to UK directors are on average 35 per cent higher than the retainer, in the US the difference is 143 per cent. In the US attendance fees are more common.

Ethnicity

In response to the UK Government's stated intention to encourage more ethnic diversity in the boardroom, the Board Index has sought to determine the number of directors in the top 150 FTSE companies who fall into the BAME category (Black, Asian and Minority Ethnic). Among companies headquartered or mainly operational in the UK, western Europe, the US and Australia, it was possible only to identify 58 directors with a BAME background. Seventeen of these are British citizens – under two per cent of the total number of British directors.

Women on executive committees

There has been a slow but steady increase in the proportion of executive committee members who are women, rising to 17.2 per cent from 15.8 per cent in 2014 and 13 per cent in 2013. It is worth noting, however, that the proportion of women among non-executives (28.4 per cent) is still far higher than the proportion of women in the senior executive ranks of the companies they oversee.

Pressing issues for boards in 2016

Risk management: expanding beyond capital and financial risk to a more holistic approach, including digital/technology risk and reputational risk, where damage can easily outweigh the original problem.

Improving the quality of explanations: while most companies in the FTSE 350 do comply with almost all of the Code's provisions, there is room for improvement in the quality of explanations where they fail to do so.

Board succession: longer-term thinking in the recruitment of new directors will continue to move up the agenda. Boards are planning beyond just replacing board members as they retire but further ahead to identify long-range challenges facing the board.

A diverse pipeline: the Davies Review has set a new target of 33 per cent women on boards by 2020 for FTSE 350 companies. The important issue of women in the senior executive pipeline remains.

Beyond the data analysis, the *2015 UK Board Index* includes articles on building a board for the long term, what boards need to know about corporate culture, the relationship between corporate culture and governance, an article exploring diversity from the shareholder's perspective and a chart showing how UK companies compare with other European markets and the US on a range of key governance measures.

For the full report go to: <https://www.spencerstuart.com/research-and-insight/2015-uk-board-index>

News

Meeting the challenge

Boardrooms are under unprecedented levels of scrutiny. Fallout from the financial crisis continues to shape the governance debate while fresh scandals over accounting, along with continued discussion of executive remuneration, have helped throw a spotlight on non-executives and their responsibilities.

Watchdogs too have played their part in demanding more from non-executives. A revised UK Corporate Governance Code has stressed the importance of risk management while regulators are bringing closer scrutiny to bear on company culture.

Meanwhile, public trust in business has suffered, prompting organisations like the CBI to develop a revised narrative underlining the significance of business in society.

Such an environment has placed a premium on boards having the right capabilities across a range of disciplines, from the core expertise of finance and corporate strategy through to digitisation, cyber-security and organisational development.

Harvey Nash set out to uncover the impact of these developments with its second annual research on non-execs and chairmen.

Key findings

Whilst there is an active debate to improve boardroom representation, there remains a significant challenge around true diversity of thought. One third of non-executives were from a finance background but their next biggest concerns after regulation and compliance included digitisation, talent acquisition, delivering strategy and corporate reputation.

The knowledge base of non-executives has lagged behind the rising strategic importance of digital technologies. Digitisation is the fastest growing topic of discussion on company boards, while 53 per cent of chairmen rank this expertise in shortest supply among non-execs.

The appointment process for non-executives is more rigorous. The use of a formal process and external search providers is increasing. Three-quarters of non-executives said they went through a thorough appointment process compared with 65 per cent last year, with differences between the genders beginning to disappear.

Chairmen revealed that 52 per cent were only somewhat satisfied and 14 per cent unsatisfied with the pool of non-executive talent. There is still work to be done in developing non-executive talent and the performance of non-execs.

Many boards have undergone evaluation in recent years but more than a quarter have never been evaluated. While half of all respondents had been through an external review within the past two years, more than a quarter said their boards had

never been through a board evaluation, with a further 11 per cent saying their last evaluation was three to five years in the past which is blatantly unwise.

Respondents overwhelmingly believed that the behaviour of business leaders has the greatest impact on building public trust in business. Excessive pay and a lack of transparency are also viewed as damaging the image of business. Almost nine out of ten respondents said 'good business' was the right thing to do though, surprisingly, 12 per cent could not agree with this statement.

Conclusions

Boards work in a tough environment with increased demands from regulators and more scrutiny from stakeholders, the media and the general public. This places enormous pressure on finding the right talent for non-executive roles.

While great strides have been made on gender there is still much to be done on representation of minority groups. This year's research also reveals a continued narrow focus on appointing finance experts. This leads to fresh questions about how boards are composed to avoid 'groupthink' and the importance of diversity of thought and contribution.

Likewise the rapidly increasing digitisation of business challenges boards to answer how they will maintain their own strategic knowledge of the potential risks and rewards presented by technology.

There may also be broader challenges. Chairmen report they are dissatisfied with the quality of the non-executive pool, newly appointed non-executives feel ill prepared and evaluation is not sufficiently robust or timely. While this persists, the boardroom effectiveness in many organisations will be impaired.

There have been significant improvements in the appointment process but there is still much to be done to genuinely deliver diversity of thought to ensure the business is able to thrive within the increasing demands of the competitive landscape and digitisation.

And lastly, there is the importance of setting the tone and culture of the organisation by ensuring that good business ethics in the boardroom are translated into actions.

As they say, doing good business is good for business.

This is an extract from Meeting the Challenge: Diversity, Digitisation & Boardrooms by Harvey Nash, The full report can be found at <http://www.impactexecutives.com/wp-content/uploads/2015/11/Harvey-Nash-Board-Research-2015-16.pdf>

Global News

CG programme for State-Owned Enterprises

Bolsa de Valores, Mercadorias e Futuros (BMFV), Brazil's sole listed exchange, has launched a State-Owned Enterprise (SOE) Governance Programme (the Programme) to enhance practices regarding the provision of information and corporate governance structures of SOEs. The Programme is targeted at SOEs that are publicly traded, or in the process of becoming so, and is based on concrete and objective measures that can be implemented in the short- or medium-term independently of legislation or rule changes.

The measures have been grouped into four courses of action:

Transparency – publication of an Annual Corporate Governance Letter containing basic company information; adoption of a policy for dividend distribution; strict compatibility between the State-owned or semi-public company's purpose and the legislative authorisation allowing for the incorporation of the respective company; and qualitative and quantitative improvement to the information provided by the company's reference form document.

Internal controls – management and employee action concerning the everyday implementation of internal controls and periodic training sessions; establishment of a compliance and risk management department; adoption of a policy for related-party transactions; and creation of an Internal Audit and a Statutory Audit Committee.

Board composition – there must be detailed nominations criteria covering the qualifications and expertise required of Board of Directors and the Executive Board, particularly relating to the SOE's strategic areas of activity; there should

be between five and 11 board members, at least 30 per cent of whom must be independent; and other rules prohibiting the holding of consecutive positions and establishing the duration of mandates and compensations.

Majority shareholder commitment – federal government bodies must demonstrate their commitment to corporate governance best practice. Codes of Conduct will establish rules preventing members of the Brazilian Government from making pronouncements on non-disclosed information that might impact on the market value of a company's securities, unless such disclosure is simultaneously made to the market.

The measures have been divided into mandatory and optional, depending on significance or the degree of implementation difficulty. There will be two levels of certification for SOEs that adhere voluntarily to the Programme, implementing the 25 corporate governance measures: Category 1 in which all measures are mandatory; and Category 2 in which, in addition to six mandatory measures, the SOE must obtain 27 out of the 37 optional points.

BMFV will monitor the Programme on at least an annual basis and also when it becomes aware of information that may result in the upgrading or downgrading of a category, placing certification in review until it is possible to confirm the effective adoption of the Programme's measures. After certification, the SOE may request withdrawal from the Programme but BMFV will make a final certification disclosure before ceasing to monitor the SOE.

For more information go to: <http://www.bmfbovespa.com.br/pt-br/noticias/download/Programmea-Destaque-Governanca-Estatais-Programmea-completo.pdf>

Trading governance risk for short-term results

'Many institutional investors are failing to recognise the importance of renewable energy and control emissions, or support both sustainable communities and social enterprises', according to Hermes Investment Management's second annual *Responsible Capitalism* survey. Whilst there is a growing awareness of environmental, social and governance (ESG) issues amongst institutional investors, they are placing short-term factors such as immediate income above long-term risks posed by poor ESG factors, despite most stating that ESG should be factored into processes.

The survey of over 100 institutional investors reveals that 99 per cent of respondents believe that fund managers should price in corporate governance risks as a core part of their investment analysis, alongside financial metrics such as cash flow and profit margins. In addition, 79 per cent of respondents said that they would consider significant ESG risks that have future financial implications as sufficient reason

to reject an otherwise attractive investment. Despite this, Hermes says 44 per cent of respondents feel that certain reporting requirements are driving pension schemes to think in terms of short-term returns, with 47 per cent stating that pension funds should focus exclusively on maximising immediate retirement income above other factors.

Only 37 per cent of respondents said that institutions should place a greater emphasis on 'quality-of-life' factors when investing for their clients' pension funds. The survey also shows that 58 per cent of respondents believe that the number of investment opportunities rejected by pension schemes because of ESG risks will increase only slightly over the next five years.

Respondents also said that the growing use of passive investment vehicles such as index tracking funds was likely to negatively impact the consideration of ESG issues, with 61 per cent stating that they thought large shareholders are likely to 'become unaware' of the companies in which they invest.

Global News

HK Exchange CG report review

The Stock Exchange of Hong Kong Limited (the Exchange), a wholly-owned subsidiary of Hong Kong Exchanges and Clearing Limited (HKEx), has published its latest review of listed issuers' corporate governance practices. The review, *Analysis of corporate governance practice disclosure in 2014 annual reports*, analysed the disclosures made by 1,237 issuers in their 2014 annual reports, covering the financial period from 1 January to 31 December 2014.

Findings include: 35 per cent of issuers reported full compliance with all 75 Code Provisions (CPs), a further 34 per cent complied with all but one and 98 per cent of issuers complied with 70 or more; issuers with a larger market capitalisation achieved a higher overall compliance rate than those with a smaller market capitalisation; Hang Seng Index (HSI) companies' overall compliance rate was 3.3 per cent higher than that of non-HSI companies; 12 per cent of issuers reported whether they had complied with Recommended Best Practices and 47 per cent of issuers disclosed having an internal audit function; and 60 per cent of issuers carry out internal control reviews on an annual basis.

The five CPs with the lowest compliance rates were: separation of the chairman and CEO roles (64 per cent); non-executive directors' (non-execs) attendance at general meetings (80 per cent); non-execs being appointed for a

specific term, subject to re-election (86 per cent); chairman's attendance at the AGM (87 per cent); and establishment of a nomination committee chaired by the board chairman or an independent non-exec (95 per cent). The quality of explanations given for non-compliance was varied and there was an element of boilerplate explanations which were vague and repeated year after year. However, some issuers gave informative reports that set out why they departed from a particular CP, what they would do to rectify the deviation and whether the departure was temporary. In general, however, there is room for improvement.

Amendments relating to the internal control section of the Code, coming into effect for accounting periods beginning on or after 1 January 2016, include: the board should oversee the issuer's risk management and internal control systems on an ongoing basis; on a 'comply or explain' basis, a narrative statement should be included in the CG Report on compliance with the risk management and internal control CPs during the reporting period; and issuers should have an internal audit function – those without one should review the need for one annually and disclose the reasons for the absence of such a function in the CG Report. Outsourcing the internal audit function would not be considered as a deviation from the new Code.

For the full report go to: http://www.hkexnews.hk/reports/corpgovpract/Documents/CG_Practices_2014_e.pdf

Swedish CG Code amendments

The Swedish Corporate Governance Board (SCGB) has announced amendments to the Swedish Corporate Governance Code (the Code) that take into account the European Commission's recommendation on the quality of corporate governance reporting. Also incorporated in the amendments are four sets of instructions issued by the SCGB now implemented and changes to Swedish stock exchange rules made in recent years.

A sustainability perspective has been added to the duties of a company's board of directors. The board must establish necessary guidelines for the company's social responsibility in order to ensure long-term capacity for value creation.

The board's responsibility for internal control applies not only to financial reporting but also to all relevant aspects of the company. However, formalised routines are required only for financial reporting. The corporate governance report must describe the board's actions regarding the monitoring of internal control in connection with financial reporting and regarding proper reporting to the board.

Each member of a company's nomination committee must consider carefully whether there is any conflict of interest before accepting a position on the committee.

The nomination committee must receive the full results of the board evaluation and the corporate governance report must specify how the board evaluation is conducted and reported.

The Code's section on remuneration is simplified, for example the rule that board members should not receive stock options has been replaced with a requirement that programmes targeting the board should be prepared by the company's shareholders and promote long-term share ownership.

The revised Code came into force on 1 November 2015. Newly-listed companies must now comply fully with the Code from the time of listing: previously they did not have to be fully compliant with the Code until the first annual general meeting following the listing.

Further amendments to the Code are likely in 2016 as a result of EU directives and regulation on non-financial information, on auditors and audits and the updated shareholder rights directive.

For the revised Code go to: <http://www.corporategovernanceboard.se/the-code/the-revised-code-2015>

Features

Whose culture is it anyway?

Paul Moxey reflects on a recent event about corporate culture and makes some suggestions as to how boards might up their game.

Glaziers Hall was packed on 12 November at the ICAEW Audit Quality Forum's event on corporate culture. With the cryptic title 'whose culture is it anyway?' the event attracted many of London's growing profession of corporate governance specialists as well as auditors. Corporate governance might never have been the same if a meteor had landed on SE1 9DD that evening. Here is a personal account of the evening and a few ideas for how boards can get their culture right.

The purpose of the meeting was to discuss how businesses can establish a culture that supports long-term success. This is an important subject. Problems with culture were found to have been at the heart of the banking crisis and in most corporate scandals from BCCI and Polly Peck in the early 1990s to Enron and WorldCom in the early 2000s. Problems with culture are probably also behind Tesco's accounting problems and Volkswagen's emissions scandal.

After opening addresses from Baroness Neville-Rolfe, Parliamentary Under Secretary of State for Business, Innovation and Skills, Sir Win Bischoff, Financial Reporting Council Chairman, and commentator and stand-up comedian Mark Steel the main part of the evening was a discussion involving leading figures from academia, accounting professional practice, institutional investment and the army, a non-executive director and Steel.

Baroness Neville-Rolfe wanted less regulation and was pleased that major changes are not envisaged for the UK Code of Governance. She emphasised the improvements which had been made in boardroom diversity and encouraged more. Sir Win stated that society wants company behaviour to improve, and culture to change. He recognised that addressing cultural issues is not an easy task and that strict adherence to the Code is not necessarily an indication that a company's culture is completely healthy. He said culture is 'very high on the FRC's agenda'.

The FRC recently launched its Culture Project 'to assess how effective boards are at establishing company culture and practices, and embedding good corporate behaviour, and to consider whether there is a need for promoting best practice'. It is a collaborative project, he said the FRC has received a positive response from many interested individuals and organisations to its invitation to participate. Sir Win said it will deliver practical, market-led observations to help boards and companies establish and embed their desired culture.

Sir Win also emphasised the positive role that external audit can play in culture, 'auditors need to have assurance and evidence to prove that management operates with integrity and transparency' and 'be satisfied that risk management and internal controls operate effectively, protecting the corporate reputation in addition to investors' interests'. The impact, he said, of a poor culture on risk management and control can now be part of the extended auditor's report. He noted that audit committees are also giving consideration to cultural issues.

The discussion

Here are some personal highlights of the discussion. It does not attempt to capture everything that was said. Sacha Sadan, Director of Corporate Governance, at Legal and General Investment Management, said investors can look at culture. He would like auditors to be more involved in metrics of culture. Multiple independent non-executive director Carla Stent was a senior executive at Barclays from 2005 to 2010. She said there was lots of talk there about culture and the majority of management wanted to do right for their staff but some people at the top were possibly too focused on return and there may have been a degree of a culture of fear. She said that if you empower staff and create the right values then staff can concentrate on delighting their customers.

Mark Steel agreed that most staff want to do right for customers but this is sometimes in spite of corporate culture rather than because of it. He asked if a board would want a CEO who focused on making sure staff were happy. Cynics might think not. However, Sacha Romanovitch, CEO of Grant Thornton UK LLP, said that businesses that focus on structure and culture will outperform. Former Brigadier Nicki Moffat CBE emphasised culture and leadership are inextricably linked. Leaders need to be able to trust people. In the army this comes from making leadership and empowerment everyone's business. Moffat also pointed out that if you work in an organisation you have to fit in unless you are in charge. People will fit in until they rise to a position where they can change the culture.

Implying that profit is not all that matters, Professor Verity Brown, Vice-Principal (Enterprise and Engagement) at the University of St Andrews, said that triple bottom line reporting should help companies to get the culture right. Steel, warning to his role of court jester, reflected that while all this makes sense – staff should feel valued and be able to focus on the long term – it goes against the current dominant ideology and political climate. Markets do not support long-term thinking.

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Sadan suggested that companies would ask different questions if the results of employee surveys were to be made public. Romanovitch noted that Glassdoor.co.uk will tell you what employees think about their employers. Sadan mentioned one company with well known culture problems but he said most investors don't care; 92 per cent of votes supported the management team. He suggested that investors don't want to vote against management as they don't want to lose their mandates. One comment from the audience was that there is a crisis of accountability rather than culture. Romanovitch said there is an alpha style of leadership which can be male or female. The alpha style may not be ideal. She said that internal auditors are now focusing on culture. Some of the comments from the floor expressed doubt about the ability of internal and external auditors to comment culture citing lack of training, a lack of independence and the likelihood that, owing to the need to validate their work, auditors will use a check list to 'prove' the intangible.

Assessing culture is not straight forward. Romanovitch said we judge other people by their behaviour and ourselves by our intent. Culture probably comes between the two. Brown highlighted the problem with measurement and assessment: it is said that what is important cannot be measured whereas what is measured does not matter.

In the concluding comments Steel mentioned that things are moving in favour of the public interest. Forty years ago a debate such as this one would have been inconceivable.

Comments

Although everyone was in strong agreement that culture is important it was clear that there is a variety of views about what is important.

Sadan was of the view that there was no need to pay consultants to tell companies what their culture is. This may be true but there surely is a need for boards to raise their game when it comes to living up to what the FRC says they should do. The Code says a key role for the board is 'establishing the culture, values and ethics of the company. It is important that the board sets the correct "tone from the top". The directors should lead by example and ensure that good standards of behaviour permeate throughout all levels of the organisation. This will help prevent misconduct, unethical practices and support the delivery of long-term success setting the corporate values and standards'.

The discussion shed little light on how this could be done. In this sense although the event may have achieved its stated purpose of discussing how businesses can establish a culture that supports long-term success, it was less useful in telling us

how to go about it. Here are a few suggestions for how boards could do so.

Establishing a culture that supports long-term success

Begin by considering what sort of culture the company needs. This is not as simple as saying we want one that is honest, transparent, compliant, empowered, innovative, results focused, with good teamwork and happy people etc. Nor is it sufficient to require that everyone should obey an ethical code. Boards will want people to be innovative, achievers, honest etc. They will also want to have controls and ensure people are accountable.

In practice it may be found that controls may make it harder for people to innovate, take personal responsibility or exercise common sense. The need for accountability might help qualities such as trust but it could also harm them. Boards must also ensure a suitable balance is struck between the desire for profit and the desire to avoid risk. In competitive sectors success depends on innovation but innovation is not possible without risk. If risk is eliminated it is likely profit will be too. Boards must choose what sort of culture they want. They should understand that it will mean some tradeoffs such as between profit and risk and innovation and control. They should also understand that the culture they want may be different in different parts of the company. You would not necessarily want the same culture in a selling function as you would in the finance function although there will of course be aspects of culture, such as honesty, that you want throughout.

The next step is to find out what sort of culture you have in different parts of the company, identify the differences from what the board thought it wanted then consider what to do about it. There is much more that can be done. Boards might want to assess the company's ethical health, how well its performance management system works in practice or if conflicting incentives create unintended consequences, find out if there are systemic issues that affect staff complying or not with regulations and procedures, understand and work with the company's values, consider how well the culture supports or otherwise the business model, and ascertain what risks are posed by the prevailing culture. Boards may also want to know whether decision-making is negatively influenced by cognitive biases such as groupthink. Having assessed these matters boards will want improvements made. That will be another challenge.

A future edition of *Governance* will look in more detail about how this can be done. Anyone wanting more information is welcome to contact the author.

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Feature

The changing face of activism

Cas Sydorowitz looks at the different approaches beginning to be used by activist funds in the UK and European markets.

Europe still does not rival the US in terms of the total number of activist campaigns. Year on year, the numbers are not growing, if anything they are remaining static or even decreasing in certain European markets. What is changing however, in a most profound way, is the approach used by the activist funds. There is a growing understanding within the activist community of the types of campaigns that are the most palatable and therefore successful in terms of garnering support from other more traditional, long-only investors.

Tactics used in the US often frustrate and alienate the activists in the UK and Europe, where issuers and shareholders prefer to discuss their grievances in measured, civilised conversation out of the public spotlight.

Activists have had to adjust their timescales on European campaigns to take into account one of the most important elements needed by other investors to support an activist mandate: hard evidence that there has been meaningful, sustained dialogue with management or the board. To further demonstrate this point, both Sherborne and Elliott, two high-profile activists, recently published the history of their engagement with the management teams of Alliance Trust and Electra Private Equity in the weeks leading up to two critical EGMs. Publishing email correspondence with board members may be viewed by some long UK investors as excessive and without question aggressive. However, it helped the activists to set out the timeframe for each discussion the activist has been involved in and to add weight to the activists' notional 'long term' commitment to their investment.

In preparation for future campaigns, many activist investors are coming to London to engage in 'Listening Campaigns' with many of the long-only, household name investors. Clearly the activist will have their own views on their specific target but instead of launching into their own discourse, they are more interested in hearing what other shareholders in the target view the company in question. With baited breath the activists are listening for any new or similar frustrations in regards to the stock price, management, or strategy the company is implementing. Is management taking too long to realise a turnaround? Has there been enough change since the last time that

management made a concerted effort to revise the company's fortunes? These 'Listening Campaigns' are *not* entered into with the design of formulating a plan or agreeing to strategy, but as a means of expressing the activists' views and to listen if the same criticisms echo back from the largest shareholders. These 'Listening Campaigns' are conducted over time and well in advance of any shareholder meeting. Activists are using the results or other news releases to invite others shareholders to share their views.

Activists recognise that in order to be effective they need to be sensitive to the other shareholders views and they will be most successful when the other shareholders are as frustrated and aggrieved by the performance of the company as they are. Helping to articulate the shortcomings, activists are seeking public comments from past directors or employees, to give credence to their views. Both companies and activists are soliciting views and comments from regulators, politicians, heads of industry, and other CEOs to echo their own views.

The activist needs to know the shareholder makeup of the target company. Activists have to be prepared that the long-only index style investor has both long-term returns to generate and that the very nature of an index position prevents certain managers from selling out of a stock. Is there a concentrated ownership of UK-based long-investors? Is there a significant retail community? If so, will the activist be able to reach them directly or will they need to engage with the wealth managers who have discretion over their client's accounts? In order to profile the makeup of the shareholder base, activists are employing experts in register analysis to help them create this view. A retail campaign will look very different from an institutional one, where you will need to reach out to hundreds if not thousands of retail owners to move the voting needle. Media and financial PR become very important in the process of getting the message out. Activists are using their own PR firms and proxy solicitors to engage with the target company shareholders. Town hall meetings are held to invite other shareholders to listen to their views.

Who are the relevant audiences and how can the activist most effectively engage with them? The acceptance that

Feature

more than just institutional investors should be reached out to is starting to catch on. We have seen large-scale retail campaigns being run by the likes of Elliott, such as in their campaign at Alliance Trust. Retail campaigns pose their own challenges with respect to access and costs, and the massive effort needed to mobilise votes from this community. Given a choice, I suspect many activists would look for situations that are not retail heavy. However, if most retail investors don't participate in terms of voting and you have a high proportion of retail holders in the stock of your target, the activist's holding may have a disproportionate voting impact versus the number of shares they own.

On the continent there is far less transparency over the ownership of a target company's shareholders. Using media and microsites become the de facto means of publicising your views and getting it out to the shareholder base. A microsite elevates the profile and creates a central repository for documents for journalists and other shareholders and proxy advisors. The most recent example of this is Elliott's campaign at Dialog Semiconductor, where they are trying to stop the company from proceeding with their acquisition of Atmel in the US. Their microsite www.voteagainstatmel.com includes their investment presentation, their press releases and shareholder letters and guides on how to vote. This is another example of tools often found in US proxy fights coming to Europe.

In the UK we have seen the use of other tactics that would be quite normal in the US but stood out in a UK construct of gentlemanly discourse.

The first tactic was a tool created by Elliott in their campaign at Alliance Trust. They issued their own proxy card to the retail shareholders of Alliance Trust. The proxy cards were to be returned to Neville Registrars as opposed to Computershare, Alliance Trust's own registrar. This gave Elliott valuable early intelligence as to the level of support they were getting from Alliant Trust retail shareholders. Otherwise the early voting information would only be available to the company. In the US the activists will often send out their own proxy cards and issue them in a distinct colour such as gold or yellow. Their appeal is to have the shareholders 'vote the gold proxy card'.

In fact the US and Canada are looking toward implementing a universal ballot which is so common in Europe where the activists submits their resolutions to the company and they include those items on the proxy card

they send to their shareholders. Given the asymmetry of information favouring management I would not be surprised if we see other activists employ similar tactics in Europe to give them concrete views on the numbers supporting them.

The second tactic described was employed by Worldview in their campaign at Petroceltic. Having requisitioned an EGM of Petroceltic shareholders, the company secured a legal injunction saying that they did not have to hold the EGM. Worldview issued their own statement on the date the EGM was to be held citing support from the other shareholders they had spoken to. They were in effect stating what the potential outcome would have been if the meeting had been concluded and the same level of turnout had voted.

These are common tactics used in US activist campaigns amongst many others. Seeing them appear in an European theatre is a novelty and should give pause for thought to issuers as they look to prepare for any activist activity.

Other forms of activism

Elliott has championed a different form of activism that manifests itself during M&A transactions. We have seen them return to the field of activism in a successful campaign at Alliance Trust, their first in Europe, since National Express several years ago where they ran a specific, and dedicated proxy fight. They have been very busy over the years focusing on Merger Arbitrage investing opportunities, looking to take a significant stake in a target company that is in the middle of a takeover. Their efforts are designed to block the transaction from reaching the mandatory squeeze-out level required to either delist or the compulsory acquisition level for untendered shares, causing significant enough disruption to get the bidder to increase their offer. The risks around M&A activism has increased significantly as a result of Elliott's activities in this space. They have done this in the situations set up in Table 1, in some cases just days or weeks before the tender deadline.

Their actions are not limited to taking stakes in companies that are under offer, but also getting involved where shareholders are being asked to approve a takeover. Elliott is currently running a campaign at Dialog Semiconductor, who is seeking shareholder approval to merge with Atmel in the US. Almost singlehandedly, Elliott has pioneered the 'Bumpitrag trade' in Europe being the lone voice of activism in this space. Companies need to be aware of the transaction

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Target	Bidder	Elliott's stake	Date
Quintain Estates & Development	Lose Star	12.9%	Oct 2015
Dragon Oil	ENOC	5.25%	Aug 2015
Norbert Dentressangle	XPO Logistics	9%	July 2015
Prezzo	TPG	14.9%	Jan 2015
Celesio	McKesson	27%	Feb 2014
Kabel Deutschland	Vodafone	13.5%	Sept 2013

risks that an activist could create in order to prevent a deal from going through or to make sure that it can't complete fully without their support. This is one of the most significant risks an M&A transaction faces once launched.

Even when offers are rebuffed by management as being too low, the challenge the board faces after the offer goes away is either justifying the go alone strategy or the rationale for not putting the offer to shareholders to consider. We first saw this in Pfizer's bid for AstraZeneca in May 2014. In that offer, 12 of AstraZeneca's largest 20 shareholders gave statements to the media or issued their own press releases coming out in favour or opposed to the bid. Rarely have we seen such an outpouring of investor's views about what the board should or should not do, in such a public way. We have seen a similar outcry from Syngenta's shareholders in rebuffing the bid by Monsanto, in August of this year. We will have to see what Syngenta's board does in the face of the current offer by China National Chemical Corp.

Conclusions

- Activists are becoming more sensitive to shareholders of their targets.
- Activist's process and discretion carry significant weight with many of the long-investors.
- Coming out publicly too early risks alienating some of those same investors.
- It is necessary to listen to the concerns of the other investors as much as it is about proposing your own value unlocking solutions.

- Expect boards to face more requests and challenges from activists, even if it is not in the public domain.
- Activists are starting to recognise that their investment horizon needs to be extended when looking at Europe. If they don't succeed the first time, anticipate that they will not go away and may ultimately try again.
- Long-investors may be more willing to side with an activist to placate them and to see progress instead of keeping the company in a state of heightened defence rather than focusing on the business.
- Institutions are prepared to get behind some activist campaigns either due to their own frustrations or when they agree with the arguments being put forward by the activist.
- In an environment of low interest rates, generating outsized returns is not easy and if long-investors can post greater portfolio returns by supporting an activist, it is worthwhile.

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Cas Sydorowitz is CEO of Georgeson Inc. <http://www.georgeson.com/uk> He has a longstanding knowledge of global proxy voting mechanics and key governance matters affecting issuers and shareholders globally. Having worked for several activists and against many more he has in-depth experience to support investors or issuers in complex, sensitive activist campaigns. Cas remains an ongoing adviser to the UK Department of Business, Innovations and Skills (Formerly the DTI) as well as the UK Takeover Panel and the London Stock Exchange on various corporate actions, and proxy related matters.



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