



# Breakfast with Lord Myners and Harlan Zimmerman

Thursday 19 March 2019

**KPMG Board Leadership Centre**



Lord Myners and Harlan Zimmerman, chairman and senior partner, respectively, at Cevian Capital, joined our FTSE350 breakfast to explore ‘constructive activism’ and why being a shareholder doesn’t just give you rights, but a responsibility to make investee firms the best they can be.

## **What is ‘constructive activism’?**

There was a time when the prospect of activist shareholders struck fear into the board of directors. And for some, it still does. “Aggressive”, “hostile”, “ruthless” are words that spring to mind and are often enough to get investment banks rallying their M&A teams and preparing a takeover defence.

But there is a much less confrontational side to the activist spectrum too.

Activism is best defined as when an investor makes an investment predicated on making something happen. In part this arises due to what Lord Myners has called “the Ownerless Corporation”.

Event-driven funds, typically US in origin, normally take small ownership stakes in companies with fragmented share registers. The playbook is often to push publicly and aggressively for actions designed to release value in the shortest time possible – such as capital distributions and M&A.

“If there is a problem, you exit,” says Lord Myners, and the ownership model suffers a blow as other investors take their leave. “Another option is to build a material shareholding and express a voice.”

And that is where ‘constructive activism’ comes in. “It’s about building a long-term relationship, between investor and company, with the intention of making the business better, more competitive and more valuable for all shareholders and stakeholders.”

## **Contributing from within**

A ‘constructive investor’, like Cevian Capital, would typically focus its investments across a very small portfolio (say twelve companies), and take a long-term view. Cevian’s average holding period is five years.

And while other activist investors engage in proxy battles or public campaigns, a ‘constructive activist’ looks to influence from within – Cevian Capital has its own professionals serving as board members in most of its portfolio companies. Though it is fairly commonplace for big and long-term owners to have board seats in Continental Europe, this is still relatively rare in the UK.

It means, of course, that during closed periods, the ‘constructive activist’ faces the same trading restrictions as the directors of their investee companies. On the plus side, its board member has transparency over operational performance and is able to directly influence strategic decision-making. In some companies, the constructive activist will be the “anchor shareholder” and in others a “catalyst for change”. Often it is about pushing the companies to reach the right ambition level.

“We relish being insiders,” says Lord Myners. “It means the company is running its ideas past us and is seeking our input. And we can funnel information back to the board.”

While fragmented ownership has its place, giving every person an opportunity to share in corporate performance, Lord Myners feels “mainstream fund managers rarely have influence over outcomes... yet they take US\$1 trillion in rents”. In time, he feels there needs to be a complete re-engineering of the fund management sector and that “more companies will build their share registers around longer term investors who care about outcomes for all stakeholders”.

## Skin in the game

'Constructive activists' do not undertake investment lightly. In Cevian Capital's case, they only make one or two changes to their portfolio each year. "Our research process takes many months. We research the long-term fundamentals of a company, we identify improvement potential, in part via very rigorous business-by-business benchmarking with peers, and we consider the ownership and influence dynamics around the company. This includes an assessment of the board, the management, the shareholder register, and the company's current standing" explains Zimmerman. "We consider how we can help improve the company's long-term operational performance and, ultimately, its value and standing."

Typically, Cevian Capital meets and speak with more than one hundred people before making an investment – at the company itself, but also competitors, suppliers, unions, former board members and executives– to gain a deep understanding of the business, its long-term fundamentals and its improvement potential. "If, after all of that, we don't feel confident that the company can improve itself, then the investment is not for us", says Zimmerman.

If the investment ticks all of the boxes, Cevian typically builds a stake of 5 to 20% over time. A 'constructive activist's' own investor base is normally in it for the long haul too. Typically pension funds and sovereign wealth funds, tie up their capital with a 'constructive activist' for between three and five years, therefore allowing it to take its long-term view.

This type of material shareholding – the skin in the game – not only gives the activist shareholder rights, but responsibilities too. And that means working with the business, to challenge, help transform and steer it in a more profitable direction.

Though constructive activism is about positive shareholder engagement with the company, it does not come with a sugar coating. The investee company can be certain, however, that it will hear what its investor thinks directly, rather than via the press.

## Lasting legacy

When exiting an investment, a true constructive activist will want to leave behind a company that is performing well, that has a clear and functioning strategy, and that is well regarded (and valued) by the capital markets. Along the way, the constructive activist often becomes the company's biggest cheerleader and tries to assist in attracting good, long-term institutional owners to the share register. This helps ensure that the activist's exit does not unsettle or disrupt.

In common with other activists, Cevian often invests in companies with blue chip businesses and good market fundamentals, but which may have fallen out of favour with the capital markets and which are underperforming their peers. For one reason or another, the company may have experienced a recent blip and earnings may be temporarily depressed. The constructive activist will seek to turn that around over the term of its investment, developing clearer strategies, reducing downside risk and regaining the respect of the markets.

Activist shareholders come in many guises. Before going on the takeover defensive, or letting the prospect create fear, try asking what their real agenda is. It could come as a welcome surprise.

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