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Keep a lookout for the activist shareholder

They may not be highly visible in the current regulatory environment but that can always change

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Shareholder activism is common in Western financial markets, where it is used to try to create shareholder value. Numerous studies on activism have found mixed results: while some validate the value creation claim and find activism beneficial, others conclude activism creates little or even negative value.

So what is it, and why don't we see it in MENA? What is shareholder activism? Simply put, shareholder activism is when a minority shareholder, usually a hedge fund or private equity fund, believes it can unlock and increase value in its investments by influencing the company's behaviour.

Typical agendas of an activist include having the company pay out its cash balances via increased dividends or forcing the sale of certain assets or subsidiaries to generate cash to distribute to shareholders — but agendas can be broad and include many other financial and strategic decisions. Once activists attain enough shares (or votes), they typically either force a vote on a proposed shareholder resolution or use their shareholding or influence to remove or appoint board members or other key company individuals.

Strategies, issues and considerations

Activism can be informal. Activists often buy relatively small stakes in listed multibillion dollar companies, and because the required number of shares necessary to exert influence through formal process is too large and costly, they are often unable to employ formal activist tools. Instead, these activists must be able to rely on informal activism, such as circulating public letters and meeting with the CEO.

If they are influential enough, they may even make their case to the market at large by way of public announcement. Of course, not all activist investors can wield such informal influence and must instead resort to more formal means.

Sometimes it can backfire. The activist's work often only starts once it has replaced key individuals, influenced strategy and generally obtained approval for its desired mandate. Once all this is in place, strategies can still go awry, and even after additional time and effort, management and the board can lose confidence in the activists.

Activists cannot 'cry over spilt-milk' in such circumstances, and may be forced to prematurely exit their investments after incurring heavy losses. Activism can also create negative publicity. Often, the agenda of an activist involves selling off key assets and businesses of the company — and if there is no alignment between the activists and management, things may get messy and lead to public in-fighting, which in turn can lead to negative publicity and disappointing financial results.

Why doesn't it happen here? Shareholder activism often becomes contentious, leads to infighting between shareholders and company management, and requires relatively large and liquid markets and diversely held companies. These are perhaps the same reasons why activism is not common in MENA.

Activists also often provoke confrontational responses from other shareholders that may quickly turn into power struggles. Moreover, management teams are generally reactive and resistant to activists' proposals. These struggles are not favoured in MENA — where reputation and maintaining relationships with the relatively few market players is important. This is evident in MENA's 'majlis' culture, where parties prefer not to air 'dirty laundry' in public and attract unwanted attention.

This is exacerbated by the fact that there are relatively few key investors in the region, and they are often government-affiliated or family groups. When a company only has a few key shareholders, activism may result in a more adversarial and confrontational dynamic and also means it is not possible to gather the support of many minority shareholders into a powerful alliance.

Additionally, MENA investors are more likely to do future deals with each other — and thus, may be more reluctant to

avoid burning bridges.

Further factors include the legal restrictions and insufficient protections offered to minority shareholders. First, the national ownership requirements in the region impact 'foreign' hedge funds and private equity activists as they reduce the activists' shareholding flexibility and negotiating leverage. Second, there are often insufficient legal protections for minority shareholders.

For example, in many Western countries, shareholders must make an offer to purchase all remaining shares once they acquire a certain shareholding threshold (typically 30 per cent), but similar laws in MENA are generally in their infancy, remain untested or do not exist.

Looking forward

While uncommon on MENA stock exchanges, its use could increase as markets continue to mature, bringing increased liquidity, shareholder diversity, and the removal or relaxation of certain restrictions, such as national ownership requirements.

We also note that publicly listed companies in MENA tend to have smaller valuations than their American or European counterparts — meaning that less capital is required to gain a minority shareholding and become an 'activist' (though this also makes it easier to acquire large stakes in companies and make changes as majority or sole shareholder).

As a broad trend, activism and its benefits continue to increase internationally, and so is an important tool for investors, shareholders and company management to be aware of.

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