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Dealing with activist investors: A conversation with Larry Kanarek

Shareholder activists are having a profound impact on the behavior of companies. McKinsey director Larry Kanarek says executives must work with—rather than against—activists to improve performance.

Shareholder activists—who grab stakes in companies and agitate for significant change—can be a force for creating long-term value, says McKinsey director Larry Kanarek. In this video interview, he argues that activists often have valid reasons for pressing companies for change and urges executives to react more collaboratively when confronted. Working with activists, rather than against them, says Kanarek, actually can create value for all parties. An edited transcript of his remarks follows.

A profound effect

Are activists having a profound effect across American boardrooms? I think the answer is absolutely yes. I think what's given rise to activists is there's an awful lot of capital out there. And there's an awful lot of effort underway to see if that capital can earn above-average rates of return. And people are turning to lots of different types of investors in pursuit of above-average returns. There's private-equity companies, for example, and there are hedge funds. Activists are one other method by which you can put your capital to work, attempting to outperform the market.

That's what activists have actually done. With relatively few situations, they have gotten management in boardrooms, at least across America, on edge, talking about them, worrying about them. And by the way, I'm not so sure that's a bad thing, because it means they're asking themselves hard questions about whether they're doing the kinds of things that drive shareholder value, which is what activists are all about anyhow.

Creating value

Quite often, activists do have at least the kernel of a good idea, and the fact that our research shows that, on average, they are creating long-term value suggests that they're right more often than they're not. The activists I've worked with are extremely analytical, they're very sharp, very rational people. And often, they have a pretty positive story to be told that should be at least paid attention to. They're not always right, but their batting average isn't bad.

I think management often overreacts when an activist gets involved. And, by the way, I have sympathy for that. It's not a criticism; it is startling to discover that somebody now owns a chunk of your company and is going to have some direct discussions with you, and maybe your board, about what you should be doing. It's a pretty threatening feeling, so I have some sympathy, but I do think they are overreacting.

When an activist feels like your first and second response is defensive—simply refuting everything they've said—then they get defensive and go into a different posture as well. You've given them no reason to think they're not right. They still have strong convictions, so they're going to double down in intensity. And they're going to hunker down for a fight. It's a fight they're pretty good at, a fight that they know how to fight—and one that management often does not.


Sometimes the disconnect is a coldly rational point of view versus an emotional one. I also think the disconnect sometimes takes place because management really does understand something about their business, their strategy, their direction—but they're not that good at articulating it. Two of the most common things activists come in believing is that either “Your costs are too high” or “You shouldn't be in all these businesses that you're in”—that the portfolio needs a shake-up. Management teams often see more synergies among the businesses within their portfolio than the activist would.

Sometimes management's right about that, and those synergies either haven't been well communicated or they haven't been fully exploited. But their view is, “If you take out this piece of me, the rest of me is not as good.” They may have a point, but sometimes they don't—it's just they've gotten comfortable with that. When they do have a point, it also may be true they haven't really exploited the synergies as effectively as they could, and that's a good conversation to have with an activist as well.

When activists knock

I think the phenomenon of activists is just going to get more common. It's a growth industry, basically. And the best thing you can do is think like an activist.

Every year, a company usually goes about rethinking its strategy. One very useful practice is to take an outside perspective, and say, "If I were an activist, how would I view us?" And particularly, "How would I look at our share price today? How has it performed compared to peers? How are my other performance metrics? My cost structure, my revenues, my growth, my expansion—how does that stack up compared to my peers?" And if it's not stacking up favorably, why not? And how would an investor think about it? "Am I underperforming in some important way, particularly my share price? And for how long has that been? And, if I have been underperforming, what am I really doing to address it? And am I doing it fast enough? Am I doing it aggressively enough? Am I pulling all the levers that I have? Or am I doing it a bit more incrementally, thinking that we're doing the right things and over the next couple of years things will change?" That may not be fast enough, and may not even be effective enough.

When an activist knocks on the door, I think the right response is, "Come in and let's have a chat," and a pretty open chat. The first thing is not to panic, it's to hear them out and to understand the analysis they've done. Activists will usually give you some time. I would take their hypothesis. I'd analyze it. I'd be completely neutral, I'd be completely open-minded. And if you prove part of it right, you go back to the activist and say, "There's parts of what you said that we agree with, and we're prepared to do some things differently, and we'll share that with you. There are some things we don't agree with, and we'd like to share that with you, too." I think you'll get a hearing; it doesn't mean you'll always agree. But if you approach them like that—and I think more and more management teams are beginning to approach them in that spirit—I think you have a fighting chance to actually create value for everybody. 

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