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PERSPECTIVES

# TRENDS AND DEVELOPMENTS IN SHAREHOLDER ACTIVISM

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**W**ith \$25bn of capital deployed in new activist campaigns – the most in any quarter on record – the first quarter of 2018 marked the continued evolution of shareholder activism from a much-derided niche strategy into a mainstream form of investing and company engagement. The current activist landscape is characterised by three key themes explored in more detail below: increased targeting of smaller-cap companies, settlements between target companies and activist shareholders in lieu of prolonged proxy battles, and the rise of M&A-focused activism.

## **Background: what is shareholder activism?**

Shareholder activism has its roots in the 1980s, when investors began purchasing large stakes in companies and then leveraging that ownership to agitate for change. Criticised by opponents as ‘greenmailers’ or ‘corporate raiders’ who sought only short-term personal gains at the expense of long-term benefits, these investors led high-profile campaigns against companies such as RJR Nabisco and TWA. In recent years, however, activists have made significant progress in shedding the stigma of 1980s-era corporate raiding. They have rebranded

themselves as investors concerned about long term shareholder value by proposing strategic changes to languishing companies and suboptimal management teams.

Activist shareholders achieve these goals through a wide variety of approaches. One common tactic involves pressuring companies to undertake corporate governance reforms, such as changes in management and board membership. Once activists amass a sizeable ownership interest in a company (around 5 percent or more), they use that to advocate for a new CEO and board members. The market typically responds accordingly. For example, in 2017, CSX Corp. saw a \$34bn overnight increase in its market value after Paul Hilal of Mantle Ridge LP (who had amassed a 4.9 percent stake in the company) merely proposed installation of a well-known, highly regarded new CEO and five new directors.

Activists also encourage companies to engage in strategic transactions as a means of generating returns for their investors. Key strategies used by activists include: (i) directly challenging pending deals; (ii) pursuing statutory appraisal rights as a means to create value; and (iii) initiating transactions and provoking market reaction by making unsolicited acquisition proposals. For example, Carl Icahn sought to thwart the buyout of Dell's public stockholders by Dell founder and CEO Michael Dell and private equity sponsor Silver Lake Partners. After Mr Dell's buyout plans were announced in 2013, Mr Icahn announced

his large stake in Dell and waged a months-long campaign to derail the buyout on grounds that the deal purportedly undervalued Dell. As part of his strategy, Mr Icahn reportedly proposed alternative transactions and attempted to convince other shareholders to exercise their appraisal rights. Silver Lake Partners agreed to increase the transaction consideration by approximately \$350m, and the deal ultimately was approved by Dell shareholders.

Activists also focus on executive compensation. They have pressured companies to shift from what activists view as skewed incentives and overly-generous executive compensation practices to policies that more accurately reflect performance. For example, activist Marathon Partners Equity Management LLC criticised executive compensation policies as part of its 2015 proxy battle against Shutterfly Inc. As a result, Shutterfly changed the metrics used by the company to determine executive pay. In addition, activist shareholders have pushed for increased disclosure of executive pay clawbacks due to misconduct.

Other areas of focus include operational activism (e.g., pushing companies to cut costs or pursue new business strategies), balance sheet activism (e.g., returning more cash to stockholders through share buybacks) and special interest activism (e.g., focusing on social, political or environmental changes, such as sustainability).

The increasing ubiquity of shareholder activism has compelled companies and their boards to



modify their approaches to preparing for and responding to activist campaigns. Well-established measures such as poison pills and changing by-laws to address how activists communicate with other shareholders are still employed. In addition, companies are increasingly adopting cooperative approaches to dealing with activists, particularly as institutional investors have become more willing to lend their support to activists. As a result, many companies have taken measures to foster shareholder engagement, such as working to maintain strong relationships with significant shareholders and engaging in open dialogue with activists.

Although the United States remains the most prominent arena for shareholder activism, shareholder activism is also on the rise in markets outside of the US, particularly in Europe. The rise of shareholder activism in Europe has several causes, including shareholder-friendly corporate laws in countries such as Switzerland presenting tempting opportunities, the recent strong performance of European equity markets, and American activists seeking more opportunities in less-crowded markets abroad. Indeed, a number of US-based funds have launched prominent activist campaigns against major European companies. For instance, Third Point LLC used its \$3.5bn stake in Swiss food

giant Nestle to agitate for major change, including selling off Nestle's stake in L'Oreal and increasing capital return to investors. European activists have also been active – for example, London-based TCI Fund Management successfully campaigned French aerospace company Safran SA to lower its offer price for Zodiac Aerospace in 2017. With \$7.2bn of capital deployed in new activist campaigns involving European companies in the first quarter of 2018, according to Lazard's '1Q 2018 Activism Review', activist activity in Europe is likely to continue to increase.

### **Current trends in the shareholder activism landscape**

An examination of shareholder activism in 2017 and 2018 reveals a number of overarching themes that are likely to continue into the second half of 2018 and beyond. First, smaller-cap companies are increasingly targeted by smaller, younger funds. A J.P. Morgan report suggests that approximately two-thirds of all 2017 US shareholder activism campaigns were launched against companies with market caps below \$500m. There are a number of likely factors responsible for this development, including the lower cost of building a significant position to gain leverage over the smaller target company's management and board.

Second, companies are settling disputes with activists instead of engaging in prolonged proxy battles culminating in a shareholder vote via a contested election. In 2017, for instance, only 19 of

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the 54 completed US activist campaigns involving a proxy battle reached the shareholder vote stage, according to the J.P. Morgan report. This trend toward settling with activists has also been reflected in activity in the Delaware courts.

Third, activists have been trending towards M&A-focused activism, as they increasingly work to push forward deals (including by facilitating unsolicited acquisition proposals) or thwart existing deals. In the 2016 and 2017 proxy seasons, over 500 M&A-focused demands were made by shareholder activists globally. Because activists can make corporate control transactions more likely in a variety of ways – including by pushing a reluctant board to engage with an acquirer on a proposal

that the board was not initially interested in and convincing other shareholders that change is necessary – acquirers have increasingly been able to take advantage of the environment facilitated by activists. As an example, Roark Capital Group acquired Buffalo Wild Wings soon after Buffalo Wild Wings' proxy fight with Marcato Capital Management LP culminated in Marcato winning three board seats. Activist shareholders have also played roles in scuttling or improving deals, as demonstrated by SandRidge Energy's decision to end its plan to purchase Bonanza Creek Energy in response to pressure from Carl Icahn, who had reportedly criticised the deal as nonsensical and overpriced. Likewise, Paulson & Co., Inc. and P. Schoenfeld Asset Management successfully pressured Deutsche Telekom AG to sweeten the terms of a merger between its subsidiary T-Mobile USA and MetroPCS after the activists publicly campaigned against the original deal terms.

## Conclusion

As activists continue to expand their already formidable place in the market, the vigorous debate on the effects of shareholder activism – particularly regarding the question of whether the actions of activist investors actually benefit target companies and their non-activist shareholders – continues. Supporters of activism argue that it is a legitimate means of improving corporate governance and strategy, which can lead to increased growth and

corporate efficiency for the target corporation and ultimately increases in stockholder value. Detractors assert that activists remain overly focused on short-term performance to the detriment of other shareholders. They also question the ability of activist shareholders to nominate qualified candidates to management and board positions. Despite their differences, however, supporters and detractors generally agree that shareholder activism is here to stay. The recent trends and developments in shareholder activism forecast yet another busy year for activists and target companies in 2018. **CD**



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