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Shareholder Activism: Who, What, When, and How?

Posted by Mary Ann Cloyd, PricewaterhouseCoopers LLP, on Tuesday, April 7, 2015

Tags: Engagement, Hedge funds, Say on pay, Shareholder activism, Shareholder proposals, Shareholder voting, Withhold votes
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Editor's Note: Mary Ann Cloyd is leader of the Center for Board Governance at PricewaterhouseCoopers LLP. The following post is based on a PricewaterhouseCoopers publication, available **here**.

Who are today's activists and what do they want?

Shareholder activism spectrum

"Activism" represents a range of activities by one or more of a publicly traded corporation's shareholders that are intended to result in some change in the corporation. The activities fall along a spectrum based on the significance of the desired change and the assertiveness of the investors' activities. On the more aggressive end of the spectrum is hedge fund activism that seeks a significant change to the company's strategy, financial structure, management, or board. On the other end of the spectrum are one-on-one engagements between shareholders and companies triggered by Dodd-Frank's "say on pay" advisory vote.

The purpose of this post is to provide an overview of activism along this spectrum: who the activists are, what they want, when they are likely to approach a company, the tactics most likely to be used, how different types of activism along the spectrum cumulate, and ways that companies can both prepare for and respond to each type of activism.

Hedge fund activism

At the most assertive end of the spectrum is hedge fund activism, when an investor, usually a hedge fund or other investor aligned with a hedge fund, seeks to effect a significant change in the company's strategy.

Background

Some of these activists have been engaged in this type of activity for decades (e.g., Carl Icahn, Nelson Peltz). In the 1980s, these activists frequently sought the breakup of the company—hence their frequent characterization as "corporate raiders." These activists generally used their own money to obtain a large block of the company's shares and engage in a proxy contest for control of the board.

In the 1990s, new funds entered this market niche (e.g., Ralph Whitworth's Relational Investors, Robert Monks' LENS Fund, John Paulson's Paulson & Co., and Andrew Shapiro's Lawndale Capital). These new funds raised money from other investors and used minority board representation (i.e., one or two board seats, rather than a board majority) to influence corporate strategy. While a company breakup was still one of the potential changes sought by these activists, many also sought new executive management, operational efficiencies, or financial restructuring.

Today

During the past decade, the number of activist hedge funds across the globe has dramatically increased, with total assets under management now exceeding $100 billion. Since 2003 (and through May 2014), 275 new activist hedge funds were launched.

Forty-one percent of today's activist hedge funds focus their activities on North America, and 32% have a focus that spans across global regions. The others focus on specific regions: Asia (15%), Europe (8%), and other regions of the world (4%).

Why?

The goals of today's activist hedge funds are broad, including all of those historically sought, as well as changes that fall within the category of "capital allocation strategy" (e.g., return of large amounts of reserved cash to investors through stock buybacks or dividends, revisions to the company's acquisition strategy).

How?

The tactics of these newest activists are also evolving. Many are spending time talking to the company in an effort to negotiate consensus around specific changes intended to unlock value, before pursuing a proxy contest or other more "public" (e.g., media campaign) activities. They may also spend pre-announcement time talking to some of the company's other shareholders to gauge receptivity to their contemplated changes. Lastly, these activists (along with the companies responding to them) are grappling with the potential impact of high-frequency traders on the identity of the shareholder base that is eligible to vote on proxy matters.

Some contend that hedge fund activism improves a company's stock price (at least in the short term), operational performance, and other measures of share value (including more disciplined capital investments). Others contend that, over the long term, hedge fund activism increases the company's share price volatility as well as its leverage, without measurable improvements around cash management or R&D spending.

"Vote no" campaign

Moving down the activism spectrum are "vote no" campaigns where an investor (or coalition of investors) urges shareholders to withhold their votes from one or more of the board-nominated director candidates.

Why?

These campaigns are rarely successful in forcing an involuntary ouster of a director, because at most companies this would require support from a majority of outstanding shares—not just a majority of the votes cast at the meeting, which is a much lower threshold. But, particularly when the challenged director is not the company's CEO/chair, a "vote no" campaign can influence the candidate to voluntarily withdraw from the election. If the level of "negative" vote was relatively significant, a director may be replaced during his/her subsequent term.

Who?

These campaigns are usually sponsored by public or labor pension funds.

Source: PwC, Broadridge, ProxyPulse Third Edition 2014, October 2014.

Shareholder proposal

Further down the spectrum is sponsorship of a shareholder proposal (or, more often, the threat of a shareholder proposal).

Why?

The goal of these investors is usually to encourage one of four types of change.

- A change to the board's governance policies or practices (e.g., declassify the board, adopt majority voting, limit the company's ability to shift legal fees to unsuccessful shareholder litigants, remove exclusive forum bylaw provisions, provide transparency around succession planning, provide proxy access), or a change to the board composition (e.g., increase board diversity, name an independent director as chair);
- A change to the company's executive compensation plans (e.g., a change in vesting terms);
- A change to the company's oversight of certain functions (e.g., audit, risk management); or
- A change to the company's behavior as a corporate citizen (e.g., political spending or lobbying, environmental practices, climate change or resource scarcity preparedness, labor practices)

Recently, some investors have also used shareholder proposals to address more fundamental changes to corporate strategy (e.g., break up the company, sell certain assets, return capital to *shareholders, or retain an advisor to evaluate alternative ways to increase shareholder value). These proposals are usually related to a more assertive activism campaign, as discussed under "Hedge Fund Activism."* Source: PwC analysis, The Conference Board, *Proxy Voting Analytics (2010-2014)*, November 2014.

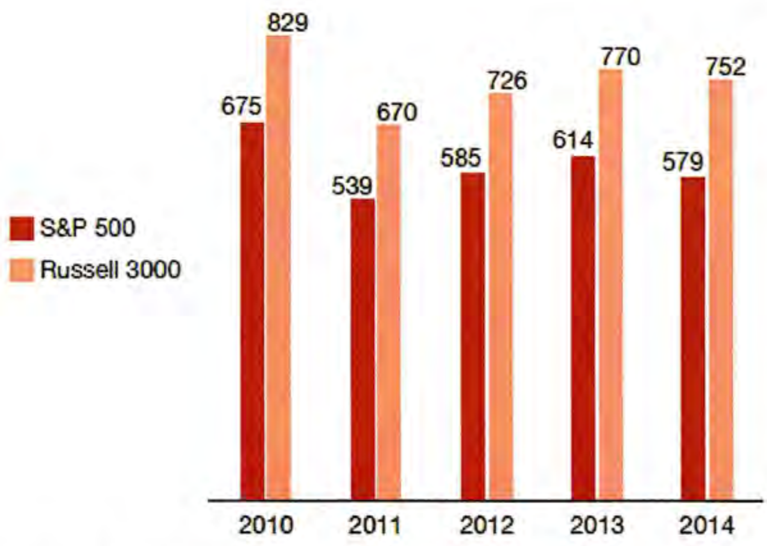
Who?

Shareholder proposals are sponsored by a wide range of different types of investors:

- Governance, executive compensation and risk/audit oversight proposals are usually sponsored by public pension funds, labor pension funds, or individual investors. These investors believe that these changes may promote more effective corporate governance (including more reliable financial reporting), and that good governance enhances shareholder value.
- Environmental and social proposals are usually sponsored by labor pension funds, ESG-oriented investment managers, religious groups, or coalitions of like-minded investors. These investors believe that these changes may provide broader societal value which also—over the long-term—benefits the corporation and all of its stakeholders.
- "Shareholder value" proposals are usually sponsored by hedge funds as a component of a more assertive activist campaign.

Shareholder proposal volume, by index (2010-2014)

Number of shareholder proposals



Source: The Conference Board, *Proxy Voting Analytics (2010-2014)*, November 2014.

Say on pay

On the more passive end of the spectrum are investor activities triggered by a company's "say on pay" advisory vote proxy item. These activities are usually limited to letters to a company (typically directed to the compensation committee of the board) or meetings/phone calls with the company (typically involving the company's general counsel, corporate secretary, and/or compensation committee chair).

Why?

The goal of these conversations is, generally, either to effect a substantive change to the compensation plan, or to alter how it is described in shareholder communications.