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RECENT DEVELOPMENTS IN SHAREHOLDER ACTIVISM

BY RICHARD GROSSMAN AND HOUSTON ADAIR

Any cursory review of the latest business and financial headlines will reveal that the topic of shareholder activism has taken corporate America by storm. What accounts for this phenomenon? While numerous factors contribute, we draw attention to four prominent trends driving the continued evolution of this increasingly high-profile asset class: 1) the dollars invested in the activist space continue to grow, and new activist funds – which may feel the need to prove themselves – are continuing to pop up; 2) there is somewhat of a paradigm shift underway in how traditionally passive institutional shareholders view shareholder activism, resulting in an increased focus on shareholder engagement by public companies; 3) large, well-known public companies – even companies performing relatively well – have become the target of shareholder activists; and 4) activists are teaming up in novel ways, either with each other, with public pension funds, with real estate entities or, in one recent example, with a corporate acquiror.

As activists deliver outsized returns, capital allocated to activist funds continues to grow to unprecedented levels with assets under management reported to approach $100 billion. The ready availability of dry powder is attracting new funds, many of which are led by individuals who learned their craft from well-known activists. These newer activists are frequently looking to make their mark in the activism space and should not be underestimated. Carl Icahn recently announced his intention to assist the emergence of this new generation of activists by seeding new funds with up to $1 billion of his own money.

It remains to be seen whether the current growth in capital available to activists will continue. While activism is developing into an alternative asset class that attracts funds from money managers seeking greater returns or looking to diversify, it is unclear if the alpha returns delivered by activist funds in recent years will be replicated on a much larger scale. To the extent that activists have already identified the easy targets (e.g., companies with clear financial and governance vulnerabilities), it is possible that we will see the capital allocated to this space begin to wane. Whether the growth in capital slows or not, though, activism is here to stay, and we will continue to see companies pressured to unlock value for shareholders.

Another trend worth monitoring is the ongoing shift in how traditionally passive shareholders view shareholder activism. Long-term institutional holders are increasingly active in making their own voting decisions rather than solely relying on the recommendations of proxy advisory services. They are also more comfortable demonstrating support for activist funds—including at the ballot box. Some have reportedly even encouraged activists to initiate campaigns at underperforming companies in their portfolios. Others, however, have exhibited more nuanced views on the subject, and indeed, some institutions have criticized the short-term approach relating to the return of capital taken by many activists.

In response to the changing views of institutional shareholders towards activism, relations between public companies and their institutional shareholders are evolving. Companies are making greater efforts to engage with their investors and strengthen those relationships. Companies and boards are recognizing the importance of regular dialogue with shareholders and are paying greater attention to shareholder perspectives on performance, strategy, compensation and governance.

Additionally, as a result of growing capital and support among institutional holders, activists are increasingly targeting large market cap companies. Greater capital permits the activist funds to pursue larger targets, and greater support enables them to pressure these companies without amassing as large of an ownership stake as would otherwise be required. Furthermore, as larger companies are targeted, activist campaigns enjoy significantly heightened media attention, which only adds to the public pressure wielded towards target companies. Activists are proving themselves adept at leveraging this media exposure, whether in the financial press or through social media outlets such as Twitter.

The lesson to take from this trend is clear: no public company is immune from an activist attack—no matter its size. Some of the same vulnerabilities that exist in small and mid-cap companies can also exist in larger companies, and large companies would be well advised to prepare accordingly. They should be proactive in monitoring their business, identifying potential weaknesses and actively engaging with shareholders. This applies even to relatively well-performing companies, as activists are increasingly willing to challenge governance provisions or capital allocation policies despite a company's respectable share price or successful financial performance.

Finally, we are seeing activists team up with others. This can occur when activists agree to form a group to increase their leverage on a company, but collaboration among activists can also be less formal than that. In many cases, a single activist will initiate a campaign, and one or more other activists will join the fray.

Activists are also joining forces with others, including public pension funds and real estate entities. Last year, California State Teachers' Retirement System (CalSTRS) joined Relational Investors in a shareholder proposal urging The Timken Company to spin off its steel business. Also last year, Corvex Management, run by a former protégé of Carl Icahn, teamed up with Related Fund Management, an affiliate of real estate firm Related Companies, to target CommonWealth REIT. More recently, Bill Ackman's Pershing Square charted new territory by partnering with a corporate acquirer in an unsolicited bid for Allergan and made additional news by retaining a prominent investment bank to assist it in its pursuit of Allergan. Whether these practices will become more commonplace remains to be seen.

In sum, a number of developments are contributing to the growth of shareholder activism. Capital continues to pour into the space, new funds are emerging and activists are receiving greater support from institutional shareholders. Large companies are increasingly at risk, and activists are partnering with others in novel ways to apply greater pressure through collaborative campaigns. While there are certainly strategies available to companies to prepare for an activist shareholder and reduce the risk of becoming a target, one thing is clear: the shareholder activism phenomenon is not going away anytime soon.

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