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Recent Trends in Shareholder Activism

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Editor's note: Richard Grossman is partner and Alexander J. Berg is an associate at Skadden, Arps, Slate, Meagher & Flom LLP. This post is based on their Skadden memorandum. Related research from the Program on Corporate Governance includes Dancing with Activists by Lucian Bebchuk, Alon Brav, Wei Jiang, and Thomas Keusch (discussed on the Forum here); The Long-Term Effects of Hedge Fund Activism by Lucian Bebchuk, Alon Brav, and Wei Jiang (discussed on the Forum here); and Who Bleeds When the Wolves Bite? A Flesh-and-Blood Perspective on Hedge Fund Activism and Our Strange Corporate Governance System by Leo E. Strine, Jr. (discussed on the Forum here).

Shareholder activism remains pervasive in the corporate landscape, as many companies continue to face new, and sometimes more sophisticated, activist situations. Recent activism-related trends indicate that the landscape is continually shifting, and companies' strategies for dealing with activism should therefore also evolve and adapt.

Increase in M&A Activism

Mergers and acquisitions activity has increasingly become a focus for activists. Lazard's Shareholder Advisory Group (Lazard) reported that approximately 46% of all activist campaigns in the first half of 2019 had an M&A angle, as activists continue to see these transactions as opportunities to increase returns for shareholders. Comparatively, from 2014 to 2018, M&A-related objectives arose in only one-third of all activist campaigns.

In addition, recent trends show that the role of M&A in campaigns can vary. On one hand, some activists have posited an M&A transaction as a campaign "thesis"—that is, a rationale for their investment and involvement in the company. In the first half of 2019 Lazard reported that approximately 65% of all activist campaigns with an M&A agenda revolved around the sale of the company, the divestiture of a noncore business line or a full company breakup. For example, in May 2019, ValueAct Capital sent a letter to the board of Merlin Entertainments arguing that the company should consider a go-private transaction in order to enhance long-term shareholder value, and the board later recommended in favor of a go-private offer. On the other hand, some activists have targeted companies to oppose a pending M&A transaction, which was the case in approximately 35% of activist campaigns with an M&A focus in the first half of 2019. This agitation, sometimes referred to as "bumpitrage," typically represents a concerted effort by activists to increase the value of their positions in a proposed transaction.

Conversely, some activists have aggressively challenged deals as not being in the best interest of shareholders. A recent example is Starboard Value's attack on the Bristol-Myers Squibb-Celgene deal in February 2019 for being "poorly conceived and ill-advised." Another is Third Point's public opposition to the United Technologies-Raytheon merger announced in June 2019. These examples demonstrate that M&A activity continues to be a key area of focus for shareholder activists, whether they are agitating for a sale transaction, seeking improved deal terms or hoping to stop a deal.

Merging of Activism and Private Equity Transactions

In recent years, the line has blurred between traditional shareholder activism and private equity transactions. In traditional shareholder activism, investors (typically hedge funds) acquire a position in a public company and seek to effect material change through certain tactics, such as proxy contests, shareholder proposals, and public and private engagement with the company's board, management and other shareholders. In private equity transactions, investment firms acquire or take a significant position in private companies (or in public companies that they seek to take private) with the goal of improving the financial outlook of the company in order to exit their positions in the future at a higher price.

Recently, these two traditionally distinct forms of investing have merged in a greater number of cases. For example, in the past two years, activist investor Elliott Management has engaged in a more traditional private equity strategy, including its acquisitions of Gigamon in 2017; its acquisitions of Athenahealth (with Veritas Capital), Travelport (with Siris Capital) and Barnes & Noble, each of which closed this year; and its settlement with QEP following an acquisition bid by Elliott. Also, in early 2019, activist investor Starboard Value stepped into the quasi-private equity space with its $200 million strategic preferred stock investment in Papa John's.

Because activists frequently identify and expose companies' perceived weaknesses and seek to capitalize on them, a private equity strategy is a natural next step. The ability to engage in a private equity-style investment or acquisition also increases an activist's credibility when it approaches a company, because the threat exists that the activist itself can and will make a bid to acquire or make a significant investment in the company. Thus, an activist investor that approaches a target company with sufficient capital and a proven willingness to take a long-term position in a company, or to take a company private, will likely pose a more legitimate threat than a more traditional activist approach (whereby an activist makes a relatively small investment in a company and seeks to effect change indirectly, such as through public demands, private engagements and other similar tactics).

Rise in "Reluctivists"

Over the last few years, there has been a rise in so-called "reluctivists," or traditionally long-only institutional investors who are engaging increasingly in activist campaigns. Recent examples, such as Wellington Management's public opposition to Bristol-Myers Squibb's acquisition of Celgene and Neuberger Berman's nomination of directors to Verint's board, display a willingness of traditional asset managers to engage in activist tactics with the goal of increasing the value of their investment. The use of activist tactics has become a more accepted way to effect change as part of a broader transition to a shareholder-centric model of corporate governance. Under this model, there is no monopoly on good ideas, and any investor with a clear agenda, sufficient resources and the support of a wide shareholder base can "become an activist." Thus, large institutional investors with significant ownership stakes in public companies are becoming more integral to the success of activist campaigns and companies' responses to them. Traditionally passive institutional shareholders are providing support to activist campaigns more frequently—generally behind the scenes, but sometimes in the open. In some cases, the shareholder-centric model has empowered institutional investors themselves to bring about change through tactics traditionally employed only by activists. The result has been the creation of an environment where even large, well-performing companies can become targets of activist campaigns launched by a variety of constituents.

Global Expansion of Activism

Shareholder activism has become an accepted strategy across global markets to bring about change. Increased activism in Europe and Asia may be driven by relatively high equity prices in the U.S., the presence of global institutional investors on targeted companies' registers, the resolution of a number of local macro issues that decrease uncertainty and a continued warming to a shareholder-centric model of corporate governance. Many larger companies in the U.S. have addressed vulnerabilities by updating their corporate governance practices to be in line with the broader market. As a result, activists have migrated to seek new opportunities in markets where poor corporate governance practices may be used as a lever with shareholders.

For example, Lazard recently noted that campaigns against non-U.S. targets accounted for 45% of global capital deployed in the first half of 2019, compared to 37% in the first half of 2018. Specifically, Europe and the Asia-Pacific region (including Asia, Australia and New Zealand) have witnessed significant activism activity in 2019, with 20% and 18% of global capital deployed, respectively. Taken together, over $8 billion in capital has been deployed in these regions this year—representing over one-third of total capital deployed in activism worldwide during the first half of 2019. Thus, shareholder activism has taken hold even in regions once believed to be either unfriendly to activists or structurally difficult for activists to execute their strategies. As shareholder activism continues to become a more common practice outside of the U.S., companies worldwide will need to develop best practices for engaging with activist investors, taking into consideration all relevant factors, including their shareholder base, cultural norms, legal framework and local political climate.

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Shareholder activism is not going away anytime soon, and the strategies to deal with activism need to evolve in response to the current environment and recent trends. Understanding how the landscape has changed in recent years will help ensure that companies are well-prepared in the event an activist surfaces.