Shareholder Activism

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What is shareholder activism? Does my company already have activist shareholders and what can we do about it?

So many different factors influence the corporate governance structure and executive compensation policies of a public company: the needs of the Company; the practices and pay levels at peer companies; the SEC’s regulatory and compliance requirements; the proxy advisory firms and their vote recommendations; top investors and their expectations. It’s this last group – the investor base – which is playing a dramatically different and more important role in recent years. Investors of all types and sizes seem to be feeling more emboldened to more actively attempt to influence company policies, particularly with regards to executive compensation design. The following discusses how companies are being affected by activist shareholders, what the best strategies for dealing with these types of shareholders are, and how the market as a whole is being affected by activists.

What exactly is an “activist shareholder”? And who are they?

Simply told, an activist shareholder is an investor who attempts to use his or her rights as an owner of a publicly-traded company to elicit dialogue and/or change at an organization.

In the wild and crazy 1980s and 1990s, the term “activist shareholder” was synonymous with “corporate raider”. Famous raiders included hedge funds led by outspoken principals such as T. Boone Pickens, Nelson Peltz, and Carl Icahn, among others. Seemingly their motto was “break up the company!” Governance and compensation concerns were not high priority. Today, however, just about any engaged shareholder can be considered activist. The evolution of the activist is quite interesting as their focus has shifted to include corporate strategy, operations, balance sheet issues, boards of directors, and M&A activity. As such, activist activity is increasingly coming not only from hedge funds, but oftentimes from mainstream institutional investors, and even “long only” investors appear to relying more on “activist”-type efforts to affect change at their investments. This means that almost every company potentially has an “activist” in its shareholder base. The IR team can no longer casually “monitor” the shareholder list in anticipation of an activist showing up; they are already there. These heavily engaged stockholders are often extremely knowledgeable about the company and are enormously invested in future outcomes of the company. Furthermore, they have deep pockets and very strong, smart teams, often equipped with analytical tools that can outstrip even the most well-meaning board.

A recent example of a very influential activist shareholder was at Coca-Cola in 2014 when Wintergreen Advisors was highly (and publicly) critical of Coca-Cola’s equity plan proposal and potential dilution implications. While the proposal passed, many would argue that Wintergreen “won”: Coca-Cola
substantially modified its equity plan. In the following year, Wintergreen Advisors expressed additional frustrations with what they deemed “excessive awards” to management, and as a result, Coca-Cola reduced its CEO’s equity package from $25 million to $14 million, with a promise to scale back the use of equity as a whole moving forward.

Activism is prevalent – and increasing
Shareholder activism truly cannot be ignored. In 2015, there were 355 activist campaigns and 12% of the S&P 500 companies faced at least some form of public activism. In 2015, 79% of activist campaigns were the only campaign for that investment manager.

Typical activist engagements
There are numerous ways activist shareholders attempt to exert influence on the board of directors or management at a company. Activist investors typically start with simply engaging in dialogue with company leaders to encourage change. This can sometimes get particularly tricky for companies when investors are identifying perceived issues with strategical and/or operational decisions that management or directors have made; to be honest, feelings can get hurt. Another hot topic for activists to criticize is executive compensation practices; again, this can be delicate subject matter, as the discussion can feel very personal for the management team. Some activist shareholders also take their concerns public, using the media to illustrate their perspective and how to unlock the value of the company. Sometimes this dissent within the company can result in lawsuits brought to the company on behalf of the shareholder. Although this type of action seems very severe, it is unfortunately not uncommon.

Activism comes in many forms. While not exclusive or exhaustive, activities can generally be broken down into four major categories:
Is your company a target?

Activist investors have been setting their sights on companies with the following issues:

- Underperformance issues (even good stock performance does not make a company immune!)
- Poor governance and board practices
- “Zombie” directors (those directors who did not receive majority shareholder support, but somehow remain on the board)
- Combined chairman/CEO
- Non-independent directors
- Lack of shareholder rights (e.g., right to call a special meeting, written consent, proxy access)
- Executive Compensation issues
- Ongoing concerns regarding executive pay – typically spurred by proxy advisor recommendations and/or media scrutiny
- Shareholder proposal received majority support and your board did not implement it
- Significant media criticism of recent mergers, acquisitions, product launches
- Identified as an outlier in environmental or social practices

My company has an activist investor, now what?

Once you are suspicious of an engagement or become a known target, what’s next? Preparation on the matter is vital when dealing with an activist investor. Below are the steps that we recommend taking when analyzing your investor base:

- Recognize the warning signs
  - The three major warning signs that activist investors go after are company underperformance, poor governance practices, and executive pay issues.
- Educate your board
  - Keep your board in the loop with periodic updates as to developments within the shareholder base and what issues may be making your company vulnerable to activist action.
- Know your existing shareholder base
  - It goes without saying that every company should have a complete understanding of how their investors vote on proxies, and understand the proxy advisor influence on each one. From the start, all companies should be engaging with their shareholders, and the proxy advisors, to ensure that everyone is on the same page. After that, it’s important to get in contact with the perceived activist right away. Be objective in your approach to the investor, and be on the lookout for unique queries about culture, people, management, and governance practices.
- Form an Internal Activist Awareness / Response Team that meets regularly
  - Monitor the suspected activist, and be proactive about knowing when to escalate.
- Have a game plan in place for a response
Once you understand the target, and know their likely escalation process, you can set a game plan for how to deal with it. Each scenario can be unique, but once a strategy is put in place it will be much easier to deal with the investor in the future.

How can I stay ahead of the game? – Key takeaways

Activist campaigns are coming in all shapes and sizes, with the definition of “activist” becoming very broad. Any size or type of company can be a target, and these campaigns are becoming increasingly successful, in all parts of the world. This is mostly a result of better targeting by activists and Boards that are less willing to fight back. Oddly, some activists are expressing regret at settling too hastily given likely outcomes. The UK is also quickly becoming a hot bed of successful activist activity, while the US market is seen by some as getting crowded in contrast.

All companies must be proactive in connecting with shareholders and understanding their perspectives. Oftentimes, it is beneficial to work with consultants and advisors to ensure you understand investor policies (like avoiding mega grants), continuously monitor vulnerability, and organize a successful shareholder outreach effort. Building trusting relationships with investors will pay tenfold, as you'll have a strong sense as to how most investors feel the direction of the company or compensation program is going. This can be invaluable when an activist approaches with an alternative company plan, and can also help mitigate concerns when you run into opposition from proxy advisor policies. It’s also extremely important to clearly disclose compensation plans and define amounts to avoid confusion or misleading information that activists could take advantage of.

Aon Governance

Aon’s governance team is here to help you understand your shareholder base, including fending off – or dealing with – an activist investor.

Sites:

- Aon Governance overview: www.aongovernance.com
- Share Authorization services: www.radford.com/equity_share_requests
- Investor Outreach and Engagement services: www.radford.com/investorintel
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