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SHAREHOLDER ACTIVISM DEFINED AND REVIEWED

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August 2014

Over the past 20 years shareholder activism has evolved from an obscure, frequently vilified strategy to a mainstream form of investing that is not only increasingly regarded for its high-return potential, but also as a necessary component of our public equity markets.

Definition and origins of shareholder activism

The term shareholder activism has become ubiquitous for what in reality is an extremely wide spectrum of investor activity. The origins of shareholder activism lay in the 1980s during the era of corporate raiders and hostile takeovers. The mass adoption of shareholder rights plans (also known as the "poison pill") brought an end to the hostile takeover era and ushered in the first activist funds during the 1990s. By the mid-2000s, the strategy became even more mainstream. There are investors who label themselves "shareholder activists" that pursue a diverse array of agendas, including:

- Share price underperformance / undervaluation
- Corporate governance – shareholder rights specific
- ESG - environmental, social and corporate governance
- Executive compensation, among other causes

As the financial media typically refers it to, however, shareholder activism is an investment strategy whereby minority shareholders (as opposed to controlling shareholders) exercise their ownership rights with the objective of improving shareholder value. In the process, activist investors proactively identify investment opportunities in which the utilization of activism can unlock value by serving as the catalyst for change. Where other active investors identify value-appreciating catalyst events and then hope for that event to occur, activist investors replace hope with action by exercising their rights as shareholders to effect change.

There are numerous change-creating tools at the activist's disposal, the most extreme being a proxy contest, which is a shareholder vote for board representation/control. In addition, activists often sponsor other shareholder resolutions and/or proposals, and utilize public filings to broadcast communication to other investors (frequently contained within the SEC 13D filing – which is a required filing for active investors that cross over 5% ownership of a public company's shares). Despite the high profile media attention certain activist investors receive, by and large, most shareholder activism occurs behind closed doors and out of the press. In fact, research by McKinsey & Co. indicates the highest return outcomes from activist campaigns come about from collaborative resolutions / settlements[1]. Although 75% of all activist campaigns start off collaboratively, 60% become hostile before they are resolved, of which approximately half end in a public threat of shareholder intervention, with the remainder resulting in either a proxy fight, litigation, or takeover bids[2]. For the most part, it is unusual for activists to attempt to outright acquire a public company.

Shareholder activism also plays a role in well-functioning public markets. For example, while shareholder activists frequently do the heavy lifting, the benefits of activism generally accrue to all shareholders. In addition, the fear of becoming the target of an activist contributes to the overall efficiency of capital markets by holding management teams accountable for the diligent stewardship of corporate assets. Increasingly, activists present well-conceived capital allocation and business plans to management ensuring that a wide variety of value creating strategies are explored. Rarely do the more collaborative activists lead with a demand to sell the company. However if management fails to pursue clear-cut value creating strategies, activists can and will push for a potential sale of the company if they believe it is in the best interest of shareholders. Lastly, shareholder activism gives the value oriented investor additional levers to pull by proactively pursuing identifiable company catalysts. This event driven optionality can be useful to investors across a wide variety of market environments.

In closing, shareholder activism plays a vital role in well-functioning capital markets, in our view, by holding companies more accountable to shareholders. It is the shareholders after all who own the company. Whether you invest directly in a targeted activist strategy, own a mutual fund or own shares of common stock in a publicly traded company, it is becoming increasingly likely that you will be touched by some form of shareholder activism during your investing lifetime. In our opinion, when an activist rings the doorbell, it is generally a good idea to answer it.

[1] McKinsey & Co. research report: "Learning to Deal with Activist Shareholders", April 7, 2014.
[2] McKinsey & Co. research report: "Learning to Deal with Activist Shareholders", April 7, 2014.

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