Companies Beware: Shareholder Activism is Back

By Sanjay Shirodkar, DLA Piper

While the phenomenon of shareholder activism has been around for some time, the middle of the last decade saw a significant uptick in such activity.

And while the 2008 collapse of the financial markets slowed down the surge, the current recovery raises this question: Has the threat to boards and companies returned?

Our answer: a resounding yes. And companies would be well-advised to make sure they're prepared.

For the past few months, it has become common to see headlines about companies targeted by shareholder activists. Recently, a major petroleum company, an iconic technology company and an oil and natural gas company were affected by some form of activism.

Earlier this year, I worked with partner Christopher Giordano and others at DLA Piper to review 41 such campaigns that commenced in 2012 against companies with market capitalizations of more than $1 billion. Our review, which did not take into account campaigns that were driven by social and corporate governance agendas or were merely suggestions, revealed the following:

- In 37 of the 41 situations, the primary activist was a hedge fund, clearly signaling that these investors are continuing to lead the charge.
- Shareholder rights plans continue to play an important role in this arena, even in the absence of a takeover threat. Twelve companies in our sample adopted this defense tactic intended to guard against a takeover after the announcement of the activism.
- Proxy advisory firms continue to support activists in most campaigns to some degree, and their recommendations in favor of a campaign correlated strongly to the outcome of the activist engagement.
- Some of the key drivers in the current campaigns include: improved economic conditions, stronger corporate balance sheets, a significant reduction in anti-takeover measures and the influx of money to activist funds. Anecdotal evidence suggests that many of the activist funds have been able to achieve double- and triple-digit returns.

Reliance solely on market capitalization to fend off activists is not a winning strategy.

Our data shows a concentration of campaigns directed primarily at the smaller issuers in the group studied. Thirty of the 41 companies had market values below $5 billion. But six, or approximately 15 percent of the companies we reviewed, had capitalizations greater than $10 billion.

To put this in some context, there were fewer than 400 listed companies in the U.S. with market caps above that level at the end of the year. While not indicative of a trend, we think this demonstrates there are a select number of activist funds with enough resources to mount credible campaigns against large companies.

In addition, one of the more significant trends we noticed was a willingness of many companies to engage activist shareholders in discussions and make some concessions that resulted in a positive outcome for the activist.

We also note that fewer companies have a robust set of anti-takeover measures in place than during previous periods of pronounced activism. Given the current state of financial markets and perceived pro-shareholder sentiment, we do not believe that many companies will adopt such measures in the near future.

Accordingly, companies need to be prepared to fend off hostile activists. We believe companies would be well-advised to conduct an annual operational and strategic review examining the following issues:

- How robust is your strategic business plan?
- Which potential weaknesses in your strategic business plan could be utilized by an activist?
- Are there any corporate governance measures, such as "say-on-pay," that could potentially aggravate certain shareholder constituents?
- Does the market fully understand and appreciate your business strategy?
- Did any activist publish a white paper about your industry?
- Have any of your competitors been targeted by activists?
- How is your performance relative to your industry peer group?
- What is your anti-takeover profile relative to your competitors?

It is unlikely that the current trend in shareholder activism will abate anytime soon.

In fact, recent developments suggest that shareholder activism might rise in 2013. Therefore, companies would be well advised to prepare for a possible campaign so that they are ready before they are targeted.

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