Interpreting the statistics on US proxy fights

Activists targeting mid-sized companies tend to be smaller, younger funds that can be more aggressive with their approach and demands.
Go to the website of The Wall Street Journal or any other major financial news source, submit a search for ‘shareholder activism campaign’ and there will be no shortage of stories on recent high-profile public battles between a listed company and one or more activist shareholders.

After reading a handful of these articles some consistent themes begin to emerge. The target: a very large, even mega-cap company, probably a household name, such as American Express, DuPont, eBay or Walgreens. All of them are massive companies with extensive resources at their disposal, including a multi-billion dollar war chest, fully-staffed investor relations and public relations departments and an army of financial, legal and other advisors with which to go into battle. And on the dissident side: a well-known activist hedge fund managing tens of billions of dollars, with many years of experience and dozens of campaigns under its belt. It’s likely a name heard regularly on the financial news, such as ValueAct, Triang, Icahn and JANA.

But how accurate then is this narrative, often described in the media, compared to a ‘typical’ activist campaign? To find out, we looked at the numbers from last year’s proxy season and the results are strikingly different. Looking at the median data from SharkRepellent on all instances in the US where an activist submitted board nominations publicly for a shareholder vote scheduled for calendar year 2016, one can see that activist targets are normally a small fraction of the size of the mega-cap targets more commonly covered in the news. Moreover, the activists themselves are not just much smaller than the likes of Carl Icahn; they also often have little or no previous activism experience.

To explain this trend, we need to look in more detail at the actual numbers and the ramifications with respect to the attributes of both the target company and the activist and what may mean for the development and outcome of a campaign.

Profile of an activist target
The median market cap for activist target companies last year was actually about $270 million, or less than one per cent of the size of the household names mentioned above. More than 80 per cent of activist targets have a market cap below $1 billion. This is for good reasons, too: there are a much greater number of potential targets in this market cap range, the cost to build a significant position in the stock is much lower and the ability to employ an M&A strategy (the most common activist objective is to seek the breakup or sale of a company) is much easier, given the greater universe of potential buyers for a smaller sized target. What are the consequences for small-cap firms?

First, an activist target of this size would have a small fraction of the resources at its disposal compared to its larger cap peers. While bigger companies may have fully staffed departments for finance, legal and investor and public relations that would be needed to fight out several months of a public activist campaign, for small cap companies those functions tend to be shared between just two or three people. As a result, the time and attention required from these staff, as well as management and the board, will be exponentially greater. That means, the distraction from day-to-day duties and the disruption to the business, will be much greater, too. Additionally, a small cap target would lack the financial resources a larger firm would have to hire experienced advisors who would have the tactical and analytical expertise often required to win a proxy fight.

Second, an activist target of this size would usually fall below the radar of the largest investment banks and top-tier law firms, where most of the activism advisor teams reside. These teams work with a client company well in advance of an activist approach to educate the management team and board about activist tactics and how to be prepared for a possible attack.

The upshot is that the typical activist target is not only small and lacks the resources to defend itself in a public battle, but also has a management team and board uninformed about shareholder activism and unprepared to respond. The typical activist target is not only small and lacks the resources to defend itself in a public battle, but also has a management team and board uninformed about shareholder activism and unprepared to respond.

Established so they know what to do in those critical moments when an activist situation first surfaces. Finally, they are unsophisticated about activists and their tactics and agendas, or about the process of a proxy fight and the strategies to win one; moreover, their regular corporate counsel may be, as well.

As a result, in 63 per cent of the cases where an activist demanded seats on a company’s board last year, the activist was successful in having some or all of its demands met. The vast majority of these via settlement, as the cost and distraction of the campaign, weighed against the uncertainty of winning a proxy contest, often causes the company to capitulate rather than to fight.

In the cases that do go all the way to a shareholder vote, more than 80 per cent of the proxy fights were at companies with a market cap of around $500 million or below and in these cases roughly one third of the time the activist was successful in winning the vote.

In terms of top sectors targeted, last year more than half of activist targets were either technology companies (30 per cent) or financial companies (23 per cent). However, the industry breakdown can vary quite a bit year to year. Look at the 13D filings (made by investors who acquire more than five per cent of a company’s common stock) that were filed in the first two months of this year versus last year, for example. The number of financial companies targeted is about half of last year, due in part to the higher valuations many financial companies have enjoyed since the US presidential election this past November, making them less viable M&A targets, while the number of energy, retail and industrial companies targeted has increased substantially. Therefore, very few if any sectors are completely immune.

Profile of an activist
The median size of activist funds that launched proxy fights last year is also smaller than one might expect: at approximately $270 million, the assets under management are much less than the many billions managed by the big names mentioned at the beginning of this article. The statistics on proxy fights that went all the way to a shareholder vote suggest that the dissident commonly has very little experience as an activist as well. Looking at the median numbers, the typical dissident in these fights has employed activism publicly as a strategy for well under two years, has only a couple previous campaigns under its belt and no previous proxy fight experience. Less than 40 per cent of proxy fights in 2016 were launched by activists that are members of the SharkWatch50, SharkRepellent’s selection of the most significant activist investors.
The involvement of a small and inexperienced activist can have important implications in terms of what tactics to expect and how a campaign might develop. Younger funds can often be much more aggressive and less nuanced in their approach and demands. If they have recently raised funds to be used for activism, these activists will be under some pressure to achieve a public ‘win’ early on, to establish a track record, gain credibility with the market and prove themselves to their investors. This means the activist might be less willing to approach a target constructively and in private and try to work together with management to bring about positive change at the company. Encounters with a younger activist fund thus often become public sooner and may be more likely to develop into a proxy fight.

Proxy fight outcomes in 2016

So how successful were activists last year in winning board seats? Again, looking at the median numbers, activists who ran proxy fights last year typically sought three board seats and were successful in getting one. In only 20 per cent of proxy fights was the activist able to get all seats sought. The typical length of last year’s proxy fights from public announcement to outcome (whether withdrawal by the activist, shareholder vote, or settlement) was just over three and a half months.

Campaigns where the activists sought a majority of the seats on board represented 35 per cent of last year’s proxy fights. As might be expected, these campaigns were typically for a larger number of seats (five) and activists were most often successful in getting two. Interestingly, in these contests for board control the activist was successful in getting all seats sought only 11 per cent of the time (almost half the success rate for minority contests), demonstrating the additional burden an activist faces to win the shareholder support to take control of the board.

As mentioned above, in the majority of cases, board seats were won by an activist via settlement rather than a shareholder vote. Looking just at the fights that did go the distance, there are some important differences. As would be expected, campaigns that went to a vote tended to last longer, typically just under six months. Although the median number of board seats sought was still three, management was more likely in a vote scenario to keep the activists from winning any seats, as the median number of seats won was zero. However, that was not the case for board control contests. In those cases the dissident was more likely than not to gain board seats and in 43 per cent of the majority contests the activist was actually successful in taking control of the board. In all votes for board control, the target’s market cap was under $500 million and in the majority of cases the dissident had no prior known experience with activism.

Conclusions

The key takeaway when looking at the statistics from last year is that in most activism campaigns both the target and activist are actually much smaller than the examples we read about in the financial news and usually have little, if any, prior experience with activism. A younger, less experienced activist is prone to agitate more aggressively and be more likely to escalate the matter publicly to a proxy fight, while the target is likely to be unsophisticated about activism and unprepared to respond to it.

As a result, in the majority of fights the activist will be successful in forcing change in the boardroom and in some cases even taking control of the board. More often than not, these conflicts can arise unexpectedly and bring about transformative change within a company, whether positive or negative, within just a few months.

In this environment, it is critical for management teams and boards at small-cap companies, regardless of sector or performance, to think ahead of time about the possibility of an activist approach. There are a number of key elements to this strategy.

First, companies should have in place an activism response plan and team, including members of both senior management and the board, as well as an external ‘go-to’ advisor team experienced in these matters. These advisors can often tell a company in advance where it might be more vulnerable to criticism by an activist and can work with the company to mitigate those vulnerabilities.

Secondly, companies should regularly seek feedback from their various shareholder constituencies to be aware of their views on potential issues and how they can be resolved. Given how unexpectedly an approach from an activist can occur and how quickly a conflict can escalate, the most effective practice is to be prepared well in advance of a campaign being launched.