The corporate provocateurs

David Prosser is on the trail of the activist shareholders breathing down th necks of companies slow to unlock value – but is it all good for investors?

Hollywood's summer blockbuster films have been a costly flop this summer. One man revelling in the Hollywood A-listers' embarrassment is the New York hedge fund billionaire Daniel Loeb, whose firm Third Point revealed in May that it owns a 7 per cent stake in Sony. Loeb is lobbying for a break-up of the Japanese electricals giant, whose entertainment unit is the maker of a number of those failing films.

Loeb is one of a growing number of activist investors who look for profit by taking small but significant stakes in companies and then lobbying for reforms they expect to release shareholder value. Such activists target companies perceived to have sleepy managers, too much cash, or ill-fitting subsidiaries that might be profitably sold off. And while they can't force change alone, they canvass support from other shareholders as they take the fight to management.

These battles are good box office fodder in themselves, with both sides using the media to make their case, often in colourful language. But activism generates more than just hot air.

In June, Apple promised to distribute $100 billion (£65 billion) to shareholders over the next three years, following a campaign from activist investor David Einhorn, whose Greenlight Capital hedge fund demanded that the world's largest company share some of its vast cash reserves with shareholders. Last year, Yahoo fired its chief executive following a run-in with activist investors. Other US businesses facing similar campaigns currently include Pepsi, Netflix, Dell and Microsoft.


Nick Arnott

"Engaging with companies can make a positive difference to returns"

Meanwhile, the Swiss bank UBS is facing calls to break itself up from activist investor Knight Vinke, which has a track record of attacking Europe's largest companies, including HSBC and Shell.

In the UK, we have also seen a different type of investor activism in action. In last year's 'shareholder spring', companies large and small were humiliated by shareholders in AGM votes on pay, auditor appointments and even the re-election of directors. Investors claimed several scalps – including Andrew Moss, the chief executive of Aviva, who stood down after shareholders refused to endorse the remuneration package granted to him.

Activist rationale

Companies targeted by activists often seek to portray their pursuers as 'corporate raiders', accusing such investors of being motivated by the desire to turn a quick profit, rather than any interest in the long-term value of the company.

For their part, activists argue they are holding to account companies whose managements have become complacent. Moreover, while corporate raiders of the 1980s may have been unpopular, they were only able to achieve their objectives with the support of shareholders upset that their stakes in under-performing conglomerates did not reflect the value of these companies' constituent parts.

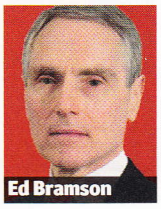
Tim Gregory, head of UK equities at Psigma Investment Management, thinks the current crop of activist investors may

Investment trust activists lead the way

Britain's sometimes sleepy closed-end fund sector has been a hotbed of shareholder activism for more than two decades. Recent examples have included the persistent targeting of Alliance Trust by the hedge fund group Laxey Partners, which often crops up on investment trust share registers. Earlier this year, activist investors including Weiss Asset Management forced the wind-up of Impax Asian Environmental Markets. A similar fate befell Active Capital Trust last year.

Activists such as Laxey and Weiss generally target trusts whose shares are trading at wide discounts to net asset value, demanding corporate actions such as buy-back schemes that can narrow the discount irrespective of the underlying portfolio's performance. A wind-up is the ultimate threat, but has the same effect, forcing the trust to realise its assets and distribute their value to investors.

That does create conflict: investment trusts often complain they're being forced to focus on strategies to produce short-term share price gains, rather than on earning long-term returns on their assets. Those that have been wound up say investors would have got better returns biding their time.


Ed Bramson

His campaign at F&C was such a success he now chairs the group

Nevertheless, where the discount does come down, there's no denying that investors get a benefit. In the current market environment, which has seen investment trust discounts narrow sharply this year, there are fewer opportunities for the activists to exploit. Several trusts continue to cast nervous glances at their share registers and these are situations for investors to watch closely.

Most notably, Sherborne Investors has built a significant stake in 3i. Sherborne is run by Edward Bramson, whose investor activism campaign at F&C Asset Management two years ago was so successful that he now chairs the fund manager.

Two other trusts to watch are BlackRock New Energy and Alternative Investment Strategies, where Weiss has shareholdings.

It's also possible to seek to anticipate activist interventions before they take place. Also, even without an activist getting involved, there may be scope for gains as the discount narrows on its own account – you're essentially buying on the cheap. But there's no guarantee of when that will happen – or even that it will.

be a catalyst in unlocking the value tied up in many companies, particularly given the large cash piles so many corporations have built up in response to economic uncertainty since the 2008 financial crisis.

'Critics accuse such investors of forcing managements to take short-term decisions,' Gregory argues. 'However, we say it is the continued economic and political uncertainty that makes it plausible for management to give investors respectable returns via higher dividends, rather than undertaking highly capital-intensive, potentially riskier capital projects.'

If the activists can make that case, Gregory suggests they may create profitable opportunities for investors who follow them. 'We would not advocate investing solely in a portfolio of shares driven by activist investors,' Gregory cautions. 'But there is little doubt it is well worth examining individual stocks targeted by activists, as a mechanism for adding a little spice to a well-balanced portfolio.'

Still, despite Gregory's optimism, the evidence that shareholders feel the benefit of investor activism is patchy. Many academics argue that a company's financial performance – its operational results and share price returns – rarely gets much of a boost from an attack by activist investors.

It seems logical that the exceptions producing sustained improvements are more likely to be instances of strategic reform – a new direction for the business, say, or the replacement of its management – than short-term measures such as cash distributions.

At Yahoo, for example, the new chief executive appears to be delivering better times for the business. Shell, meanwhile, was undoubtedly streamlined by the corporate restructuring that Knight Vinke helped force in 2004, in which the oil giant abandoned its Anglo-Dutch dual structure.

The carpetbagging craze that swept the building society sector in the mid-1990s is another positive example. As activist investors in search of a windfall from free share distributions forced a series of building societies to convert to bank status, those in the sector that wanted to stay mutual scrambled to prove the value of doing so.


Tim Gregory

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Nationwide Building Society survived a vote on demutualisation in 1998, partly thanks to its launch of a member rewards scheme promising dividend-style annual income distributions to savers and borrowers.

However, there have also been disappointments. In 2005, US fast food chain Wendy's was pressured into selling its Tim Horton's doughnut business by the activist investor Bill Ackman. The share price later collapsed – critics suggested it had been left substantially weaker by the decision to sell what had been a fast-growing subsidiary.

ACTIVISM PAYS OFF: FUNDS RUN BY ACTIVIST INVESTORS HAVE OUTPERFORMED

	Return (%) from:	
	AI Activist Index*	MSCI World Index
2006	16.3%	20.7%
2007	0.8%	9.6%
2008	-35.8%	-40.3%
2009	36.1%	30.8%
2010	25.7%	9.6%
2011	-9.0%	-8.0%
2012	16.2%	16.5%
2013**	12.5%	7.2%
Annual average	7.85%	5.8%

Notes: *After fees. **Year to date.
Source: Activist Insight

Shareholder benefits

Nevertheless, the activists' supporters are convinced investors can benefit. The British analyst Activist Insight publishes an index of the returns achieved by activist investment funds. It says such funds have consistently outperformed over the past five years (see box below). In the first quarter of 2013, for example, the index was up by 12.5 per cent, compared to 7.7 per cent from the MSCI World index.

'Engaging with companies can make a positive difference to returns,' insists Activist Insight's Nick Arnott. 'The ability of activist investors to outperform the market has seen institutional investors and banks put up greater capital for activists to wage campaigns, and all the indications are that it is worth their while.'

In which case, how do retail investors get in on the act? Predicting which companies the activists will target next is difficult; while activists typically target underperforming or undervalued businesses, that doesn't narrow the field sufficiently.

The good news, however, is that investors may not need to be in the stock in advance to benefit from activists. Returns often take a little while to materialise, as the market weighs up the likelihood of the activist getting what it wants. Investors who act quickly have a window of opportunity – assuming, that is, you think the activist is credible and making a good case.