

Active ownership

Corporate Governance

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Agenda

Overview of active ownership

Does activism create any value?

- Analysis through two case examples

Future outlook and relevant literature

Active ownership – why does it matter?

“Active ownership is one of the fastest-growing responsible investment strategies in listed equity globally.”

“regarded as one of the most effective mechanisms to reduce risks, maximise returns and have a positive impact on society and the environment – for passive and active investors.”

Activist investor in Peloton takes aim at new chief executive

Blackwells Capital says Barry McCarthy has failed to reform governance at fitness company



Blackwells wants Peloton to take a series of actions, including inviting bids for the company

Andrew Edgecliffe-Johnson in New York APRIL 13 2022

The activist shareholder which called in January for I John Foley has taken aim at its new chief executive, a McCarthy has failed to reform the connected-fitness o justify its continued independence.

Investors protest against big payouts for UK bosses

More than a third of shareholders have voted down executive remuneration in at least 15 FTSE 350 businesses this year



Average votes against pay reports across all UK companies stood at 7.3 per cent this year, according to figures from Proxy Insight, the highest level of dissent since at least 2014. © Getty

Attracta Mooney MAY 18 2021



UK companies are coming under intense pressure from shareholders over executive pay, with support for remuneration resolutions falling to an eight-year low, as investors protest against big payouts for bosses while the country grapples with the pandemic.

2 minute read · August 30, 2022 6:49 AM GMT+3 · Last Updated 3 months ago

BHP shareholders seek consistent climate policy, submit resolutions

Reuters



A small toy figure and mineral imitation are seen in front of the BHP logo in this illustration taken November 19, 2021. REUTERS/Dado Ruvic/illustration

← Tweet



Elon Musk ✓
@elonmusk

...

the bird is freed

6:49 am · 28 Oct 2022 · Twitter for iPhone

359.1K Retweets 53.7K Quote Tweets 2.5M Likes



What is active ownership?

Actions taken by shareholders to influence companies

Passive ←————→ Radical

Indirect pressure

- Selling shares
- Exclusion from investment

Influencing managerial decision making

- Shareholder proposals
- Public and private negotiations
- Voting on board proposals

Fundamental changes

- Takeovers
- Restructurings (spinoffs, selloffs, etc.)
- Proxy contests (replacing board members or/and executives)

Development of Activism



1942

Current wave of activism starts from SEC's rule that allowed shareholders to submit proposals for corporate ballots

1970

Most of the activists were individual investors. Motives are mostly financial

1980

Increase in involvement of institutional investors

1990

Regulatory changes and decline in the takeover market leads to increase of institutional investors even more

2020

All forms of activism can be seen today but the development continues. Especially increase in hedge funds and private equity funds. Increase in non-financial motives

Activism is no longer focused purely on shareholders' direct benefit

Agency theory

Activism arises from the potential gains for the shareholders from addressing the agency conflict
("shirking and stealing")

- Potential gains must exceed the costs (time, effort, knowledge)
 - Costs are carried by the activist but benefits are gained by all ("free-rider problem")
 - Chances of succeeding are uncertain



Stakeholder theory

Activism takes into account the **interests of a wider range of stakeholders** (employees, citizens, customers, etc.)

Partly still motivated by financial goals

- Companies are dependent on their stakeholders
- Dealing with stakeholder-related issues is a way to reduce risks and create additional value
 - especially relevant for large investors and funds who invest widely in the market or according to an index and cannot divest away risk

Activists are more interested in ESG topics

Financial outcomes/attributes

Performance

- Share price
- Profits
- Dividends

Strategy

- Business strategy
- Restructuring

Governance processes

- Board composition
- Board/executive compensation



ESG outcomes

Environmental

- Environmental policies
- CO2 emissions

Social

- Labour conditions
- Ethical business practices

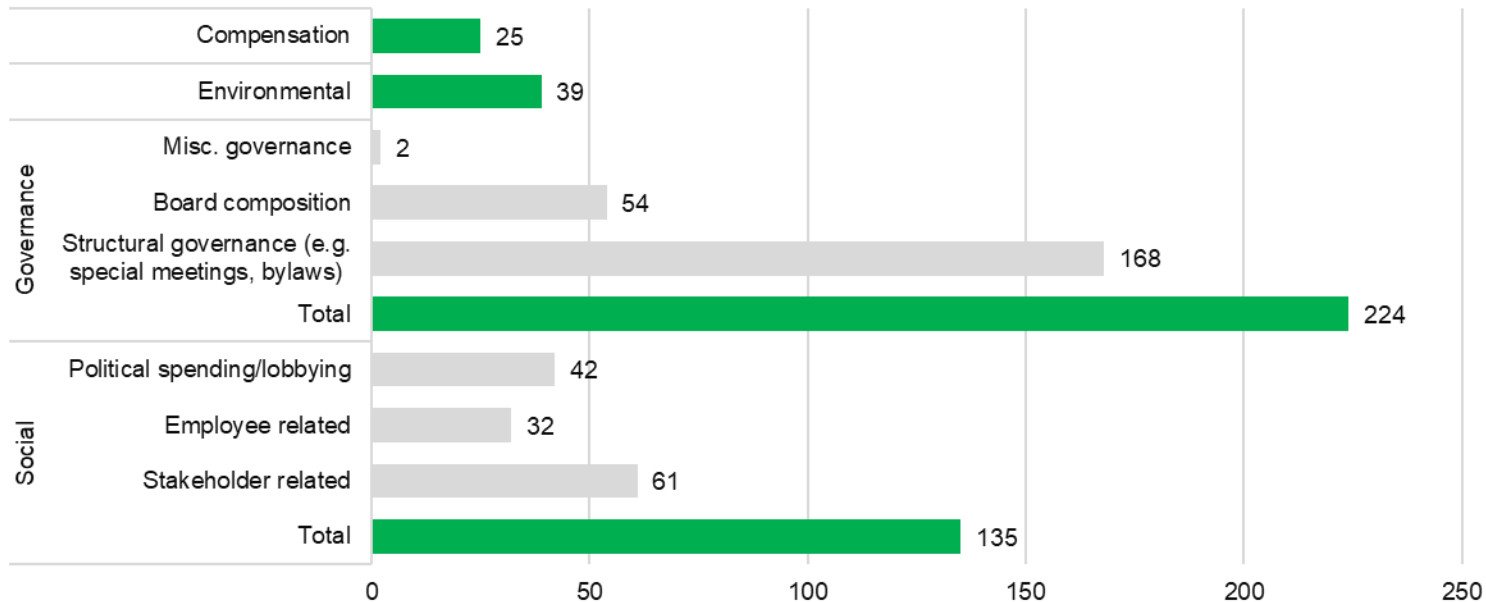
Governance

- Governance structures
- Code of conduct

“Anti-ESG”

Proposals focused on governance and social issues in 2021

USA - Rule 14a-8 shareholder proposals in 2021



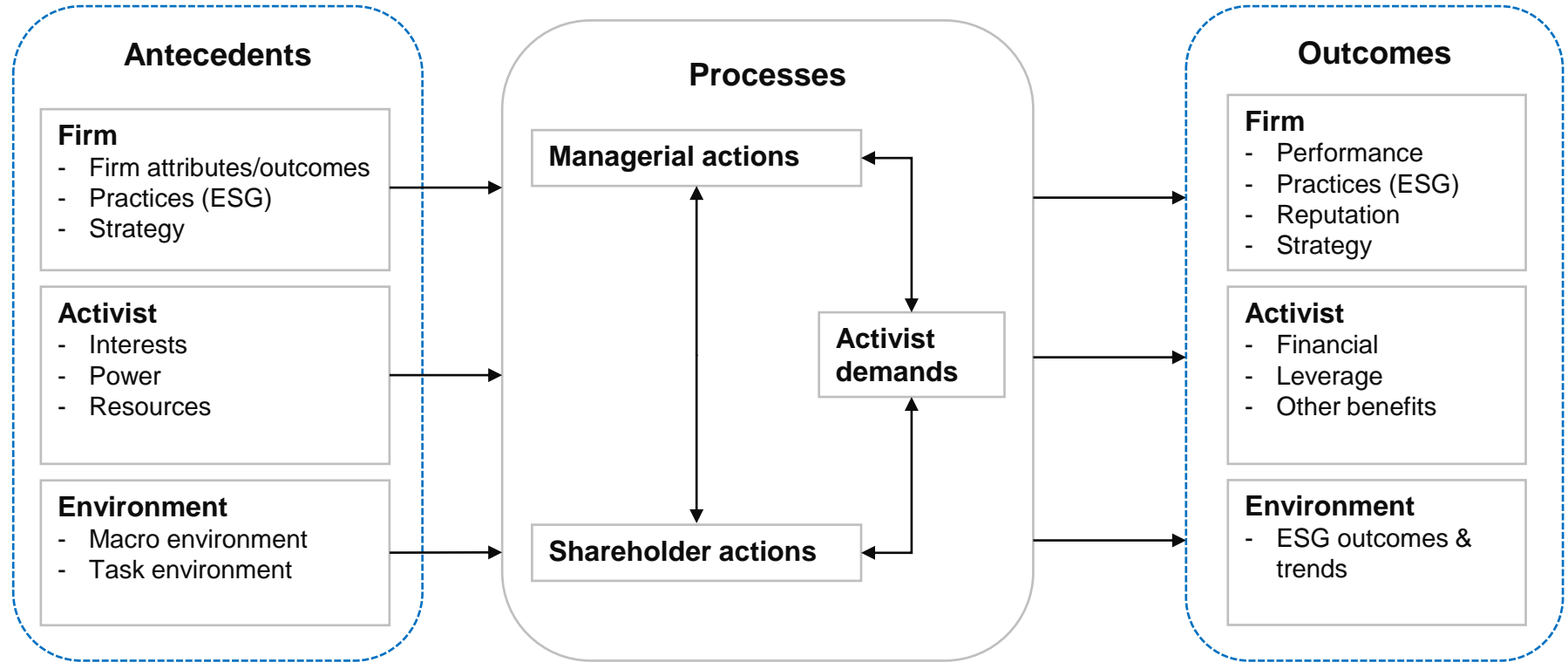
Any shareholder can be an activist

	Retail investors	Activist groups	Large non-institutional shareholders	Institutional investors	Hedge funds
Examples	Households	Shareholder advocacy groups	Owners with significant holdings e.g. founders or families	Pension funds, index funds, banks	A wide range of different types of funds with unique strategies
Common forms of activism	Voting, proposals, taking part in campaigns	Organising campaigns, negotiations, public pressure	Private negotiations, voting	Sophisticated active ownership policies	Private negotiations, proxy contest, restructurings



Available resources
Level of influence
(variation exists)

Process of activism



Does activism bring results? - Case examples on Hedge Funds

Does activism create value? How significant are the benefits?

What are the best practices for reaching outcomes?



Case 1: Lindex and Cevian Capital

In 2003, Stockholm based activist fund viewed Lindex as an attractive restructuring candidate

1. Fund acquired 10,4% blockholding -> largest shareholder
2. Holding was raised to 16% in 2005

Restructured the board and hired new CEO from H&M. Developed option-based compensation for senior managers.

Cevian also implemented operational improvement such as:

1. Improvements in inventory management, reporting and purchasing
2. 11 loss making German stores were closed and Swedish subsidiary sold
3. A new store-opening programme was released in growth markets

Cevian divested its position in 2006 and achieved abnormal returns of 85% (calculated on public information)

Case 2: Exxon Mobil and Engine No. 1

In December 2020, a small activist hedge fund launched Reenergize Exxon campaign with the goal of reducing Exxon's carbon footprint. Three primary asks for Exxon:

1. Refresh the Board of Directors with energy experience.
2. Impose greater long-term capital allocation discipline.
3. Implement a strategic plan for sustainable value creation in a decarbonizing world.

Engine No. 1 held only 0,02 % of Exxon's shares but was backed up by some of the biggest institutional investors of Exxon, including BlackRock, Vanguard and State Street

→ Combined over 20% of the votes in the annual meeting in 2021

Results:

1. Three of Engine No. 1's candidates were elected to the board
2. Multiple actions and strategy work has been made to reduce Exxon's emissions footprint during past year.
3. Followed with strong performance and major positive effect on the stock price.

Summary: effectiveness and best practices + limitations in research

Activism creates value

- Many articles report **positive returns in terms of share price** for successful engagements
 - Successful **restructurings** (excluding takeovers) are the most profitable, followed by **governance changes**
- Successful **ESG engagements also increase share price** (in addition to potential ESG outcomes)

Best practices

- **Support from other shareholders** is important
 - Activists don't typically have large shareholdings by themselves
- **Private engagements** tend to produce better results
 - Influential activists usually negotiate privately; public negotiations are typically more contentious
- Selecting the **right strategy** and having the **skills and resources** to carry out the engagement is important

Limitations in research

- **Reverse causality** is possible in some engagements
 - e.g. a firm acts in reaction to a share price change caused by a proposal
- Most studies measure returns only through share price, which does not always reflect real changes in company's performance or value.
- Research focuses on financial returns rather than ESG outcomes
- Non-public activism is hard to measure
- Multiple background factors can make it hard to isolate the impact of activism

Future outlooks

1. Increased involvement of hedge funds and private equity funds

- Have tools changed?
 - Activist hedge funds use aggressive proxy fights
 - Social media

2. Does new regulatory changes have an impact on activists?

3. How will changing macro conditions affect new campaign activity?

4. Does shareholder activism really have an impact on companies' ESG factors?

More literature on active ownership

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