Best Practices in Investor Relations: The evolution of shareholder activism

J.P.Morgan
Conducted by J.P. Morgan’s Depositary Receipts Insights team, this Q&A discusses the latest trends in shareholder activism, including the areas where activity is increasing the most. It explains what catalyzes shareholder activists and how these investors identify their corporate targets. It also provides a suggested best practices checklist for senior decision-makers and investor relations professionals to consider when their company attracts activist investor attention.

Contact us
For more information, please contact your J.P. Morgan Depositary Receipts representative.
Expert analysis

A conversation with David Hunker

He shares some of his insights and experience.

**DR Insights:** What are some of the recent macro trends in shareholder activism and are there developing ones? Is activism in a different place today versus the start and end of the financial crisis?

**DH:** When we think about shareholder activism before and during the financial crisis, most issuers were likely to describe shareholder activists as a variation of the corporate raider. Today, activism has evolved into a distinct and separate asset class or investment strategy, widely accepted by the long-only institutional investment community.

During the financial crisis, many investors, such as mutual funds, pension funds and family offices, saw a significant portion of their portfolios’ value vanish. Many shareholder activists emerged during this period, with the message that they were no longer corporate raiders but now “defenders of shareholder value.” This was a very attractive proposition for investors whose portfolios realized steep losses at the time.

Today, shareholder activism is broadly accepted by traditional long-only investors. Additionally, the lines between who is an activist and who is a passive, long-only investor are no longer clear. Some of these long-only investors are actively engaging with management and boards to agitate for change themselves. Broadly speaking, this is the definition of shareholder activism.

**DR Insights:** What level of activity are we seeing on a regional basis?

**DH:** This is an area that’s really interesting. There’s a misconception that shareholder activism is a U.S. or a European phenomenon. What we’re seeing today is a lot of activity outside these two geographies, particularly in the Asia Pacific region. Some of this is still driven by U.S. activists agitating outside the U.S., but much of it is driven by domestic investors campaigning against domestic companies. When we speak to clients outside the U.S. and Europe, we ask if they’ve ever had to deal with a shareholder activist. The answer is often “No.” But when we ask if they’ve ever dealt with a minority shareholder that is trying to force the company to make some sort of strategic or capital structure/allocation change, quite often the answer is “Yes.” Shareholder activists are often investors whose names you’ve never heard of before, or who you don’t generally associate with activism.

Ten years ago, shareholder registers of companies outside the U.S. were much more domestically oriented. Today, shareholder registers around the world often look like the shareholder registers of U.S. companies. Quite often these registers are dominated by large, global institutional investors that are used to seeing shareholder activism and are comfortable supporting shareholder activists. As we see more shareholder register evolution happening around the world, we expect that we are going to see more shareholder activism in those regions.
DR Insights: Are you seeing activists target any specific market caps?

DH: For a number of years, we’ve been in a period where activists frequently target mega-caps, although they have historically targeted small- and mid-cap companies. The reason behind the shift toward larger companies is that shareholder activists have grown. In order to effectively put capital to work, they’ve had to target bigger companies.

Additionally, the high level of institutional support for activism means activists today don’t need to control as large of a stake as they had in the past, and they can effectively agitate against a company with much smaller stakes — sometimes with less than 1% ownership.

This phenomenon raised the profile of activists even further, paving the way for new activist funds to come into the market.

DR Insights: Have you seen the shift toward passive investing affecting activist defense strategies?

DH: There was a period when passive funds voted their shares according to recommendations from proxy advisors. Today, many large institutions, both passive and active, have formed their own internal corporate governance committees, which make independent voting decisions for their funds based on internal guidelines and situation-specific information. What this means is that the influence of proxy advisors has decreased. Each investor may have a different approach for how they arrive at a decision on corporate governance issues or M&A transactions that are put to a shareholder vote.

A key takeaway from this is that it is possible to win the support of key institutional investors, even in the face of a negative recommendation from the proxy advisors.

We believe that it’s best practice for companies to reach out to large institutional investors and make it clear to their corporate governance decision-makers that the company is available and willing to have a one-on-one discussion with them. Many companies make this type of offer on an annual basis. Investors may decline to meet, but they will appreciate the effort.

David Hunker has been with J.P. Morgan since 2004. He is a member of the Mergers and Acquisitions group in New York, where he leads the firm’s Shareholder Activism Defense practice. In addition to advising corporate clients on defense strategies, Hunker’s team also helps clients evaluate their potential to be activist targets and assists them with the creation of an action plan to address vulnerable areas.
Best practice activism checklist

☐ Listen, even to investors with a relatively small ownership stake.

☐ Understand an activist’s position by engaging with them.

☐ Assess, objectively, the merits of shareholder suggestions.

☐ Implement change, if consistent with long-term value creation.

☐ Identify and engage decision-makers at each of your shareholders and how they would vote.

☐ Anticipate the proxy advisors’ likely response.

☐ Weigh the pros and cons of potential settlement/concessions.

☐ Fight/contest if necessary and in the best interest of all shareholders.

☐ Create a robust public relations strategy to be successful.

☐ Potentially provide access to senior management and possibly individual directors, if appropriate.

☐ Articulate a consistent message (directors, management and investor relations functions).

☐ Make activism defense a regular part of management and board dialogue.

☐ Engage advisors early to remain current on activist themes and strategies.
Is your board prepared?

In today’s activist-prone environment, a factor for consideration is how to ensure that the board is fully informed and prepared for the potential of shareholder activism, including:

- Knowledge of the drivers of shareholder activism.
- Understanding of recent activist campaigns.
- Evaluation of potential activist attack themes.
- Review of current shareholder base and investor dialogue.

Activism explained

Shareholder activists focus on:

- Companies with perceived unrealized shareholder value, suggesting strategies to unlock value by returning capital to shareholders.
- Big-picture strategy, such as a breakup of the company.
- Capital allocation mix.
- Corporate clarity.
- Adjustments to corporate strategy or corporate governance.

Shareholder activists identify targets through perceived weakness in:

- Stock price relative to peers
- Capital structure
- Distribution policy
- Governance
- Corporate structure
- M&A track record
- Business strategy
J.P. Morgan is a marketing name for the Investor Services businesses of JPMorgan Chase Bank, N.A. and its affiliates worldwide.

JPMorgan Chase Bank, N.A. is authorized by the Office of the Comptroller of the Currency in the jurisdiction of the U.S.A., by the Prudential Regulation Authority in the jurisdiction of the U.K. and subject to regulation by the Financial Conduct Authority and to limited regulation by the Prudential Regulation Authority, as well as the regulations of the countries in which it undertakes regulated activities. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request.

This document is provided for information only and is not intended as a recommendation or an offer or solicitation for the purchase or sale of any security or financial instrument. The opinions, estimates, strategies and views expressed in this publication constitute our views as of the date of this publication and are subject to change without notice. Any opinions expressed herein may differ from the opinions expressed by other areas of J.P. Morgan, including research. The information contained herein is as of the date of this publication and J.P. Morgan does not undertake any obligation to update such information. Any market prices, data or other information contained herein are not warranted as to completeness or accuracy and are subject to change without notice. This document does not purport to contain all of the information that an interested party may desire and provides only a limited view of a particular market, product and/or service. This document does not constitute advice by or on behalf of J.P. Morgan, and nothing in this document should be construed as legal, regulatory, tax, accounting, investment or other advice. No reliance should be placed on the information herein. The recipient must make an independent assessment of any legal, credit, tax, regulatory and accounting issues and determine with its own professional advisors any suitability or appropriateness implications and consequences of any transaction in the context of its particular circumstances. J.P. Morgan assumes no responsibility or liability whatsoever to any person in respect of such matters. Transactions involving securities and financial instruments mentioned herein may not be suitable for all investors.

© 2017 JPMorgan Chase & Co. All rights reserved.