

# Shareholder Activism Insight

A Schulte Roth & Zabel LLP report in association with mergermarket



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# Foreword

**Schulte Roth & Zabel is delighted to present the Shareholder Activism Insight, in association with mergermarket.**

Based on a series of interviews with corporate executives and activist investors, this report highlights current trends in activist investing and provides an outlook for activist investing in the year ahead.

56% of overall respondents expect to see an increase in shareholder activism over the next 12 months. 66% of respondents expect hedge funds in particular to be the most active in the year ahead, more than any other buy-side investors. In terms of specific sectors, 71% of respondents expect the Financial Services sector to see the most activist investing this year.

Respondents tend to agree that underperforming shares are the most common driver of shareholder activism, with 79% of overall respondents identifying a period of flat or negative growth, profitability or stock price as key drivers. One corporate respondent acknowledged that shareholder activists play a positive role in this respect, as they often motivate companies to pay more attention to maximizing shareholder value than they otherwise would.

Other corporate respondents had a less favorable take on activist investing. Some 48% of corporate respondents view activist shareholders as short-term market opportunists, with one corporate respondent commenting that companies' long-term goals tend to conflict with the short-term goals of activist shareholders. The same percentage of activists (48%) believes that corporate boards are passive rather than proactive when it comes to maximizing shareholder value.

Corporate respondents tend to view activist investors as short-term investors out to make the highest returns possible in the smallest window of time, but these initiatives do not necessarily drive all activists. Again, nearly half (48%) of activist respondents were passive investors for a year or more before turning active, and 67% of activist respondents hold onto their active investments for the same amount of time.

The contrast between the perspectives of activist and corporate respondents also emerges clearly on the topic of new e-proxy regulations. Not surprisingly, several respondents from both groups see the shift from paper to digital as an environmentally sound, cost effective move. But 84% of corporates and 60% of activists believe the rules will not truly benefit activists or shareholders. It is worth noting, however, that 4% of corporate respondents compared to 28% of activists believe the rules will favor activist shareholders.

In spite of these important differences, the majority of corporate executives (58%) and activist investors (56%) agree that open communication with management is the most effective strategy for successful activist investors. Similarly, the majority (67%) of corporate respondents believe the best defensive strategy a company can use against activism is maintaining an active dialogue with its shareholders.

Communication seems to be the key, both as a defense mechanism against shareholder activism and maintaining a positive relationship between a company and its activist shareholders. Shareholder activism evokes significantly different reactions from shareholder activists themselves and corporate executives throughout this report. This report highlights these remarkably diverse perspectives and also sheds light on the common goals of companies and their shareholders, and the most effective way to improve the relationship between the two groups. We hope you find this report informative and useful, and we welcome your feedback.

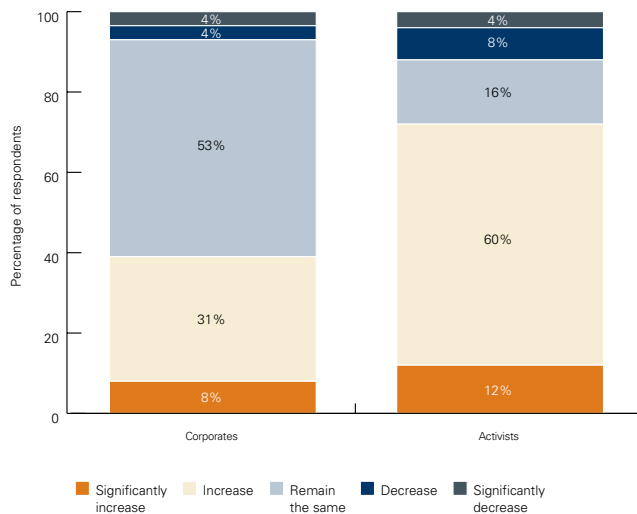
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## Methodology

Schulte Roth & Zabel commissioned mergermarket to interview 25 senior corporate executives and 25 activist investors regarding their experience and opinions of shareholder activism. All results were anonymous and have been presented in aggregate.

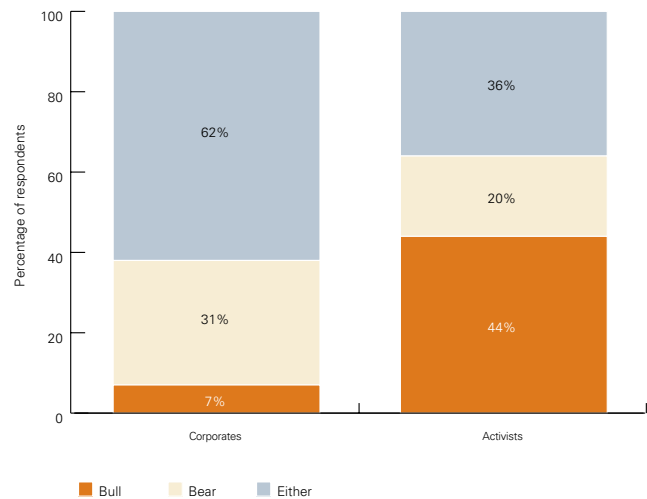
# Study findings

*What do you believe will happen to the volume of shareholder activism in the next 12 months?*



- The outlook for shareholder activism is markedly different between corporate executives and the activist shareholders themselves. 72% of activists expect the volume of shareholder activism to increase in the year ahead, compared to only 39% of corporate respondents. The two respondent groups generally agree, however, that a decrease in shareholder activism is unlikely, with 8% of corporate respondents and 12% of activists expecting a decrease in the next 12 months.
- More than half of corporate respondents (53%) expect no change in the level of shareholder activism in the upcoming year.

*Does shareholder activism happen mostly in a bull market or a bear market?*

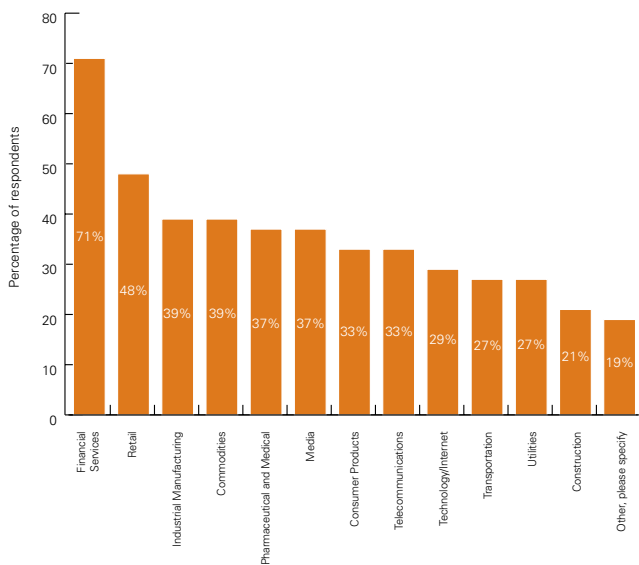


- Respondent groups also hold different views on the impact of market conditions on activist investing. Whereas the majority of corporate respondents (62%) believe that shareholder activism is as likely to happen in a bull or bear market, activist respondents (44%) tend to favor a bull market.

*“Corporate executives are not expecting the increased level of activism the activists predict. But a bear market may temper that increase.”*

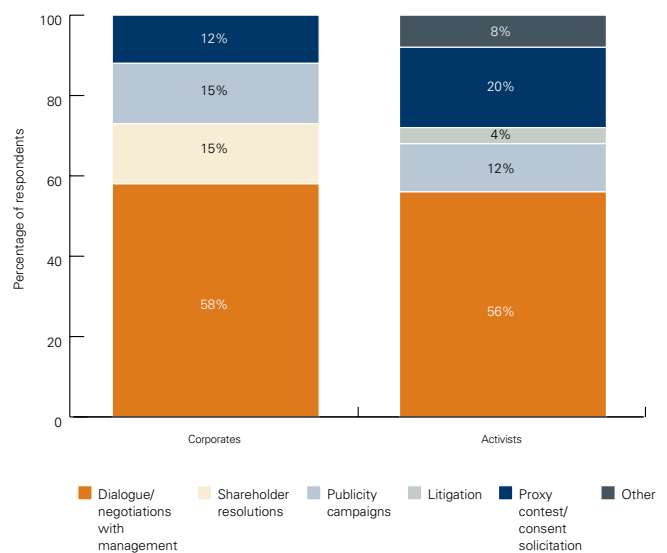
*Marc Weingarten, Partner, Schulte Roth & Zabel*

*In which sectors to do you expect to see the most activist investing in the next 12 months? (select all that apply)*



- 71% of overall respondents expect the Financial Services sector to witness the most shareholder activism in the upcoming year, making this the only sector chosen by a majority. A significant 48% of respondents expect the Retail sector to see the most shareholder activism in the same time period.
- All remaining sectors were chosen by between 20% and 40% of respondents. One corporate respondent explained why few sectors stand out from the rest: "Shareholder activism is not sector specific. It all comes down to individual performance."

*Which activist strategy is most effective for achieving desired results?*



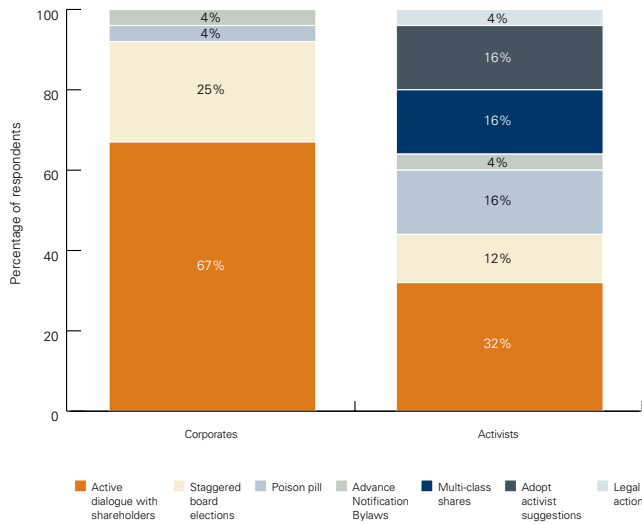
- 58% of corporate executives and 56% of activist investors are in agreement that the most effective activist strategy is open communication with management.
- Interestingly, activist investors were the only group to cite litigation as the most effective strategy, and then only 4%.
- One activist investor explained: "Having a figurehead – an influential figure to make decisions – is most important as activists are often not heard unless they use an aggressive approach." Additionally, no shareholder activists identified shareholder resolutions as the most effective approach, although 15% of corporate respondents believe this approach is actually most effective.

*"Both constituencies agree that the most effective activist strategy for achieving desired results is a dialogue or negotiation with management. We believe it is a real mistake for management to refuse to engage in discussions with activists."*

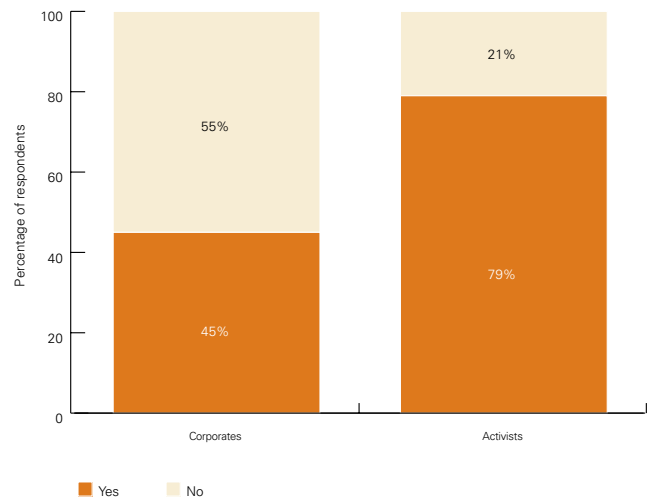
*David Rosewater, Partner, Schulte Roth & Zabel*

Study findings

*What is the most effective defensive tactic a company can use against activist shareholders?*



*Do you believe the SEC should adopt rules giving shareholders access to nominate directors in a company's proxy statement?*



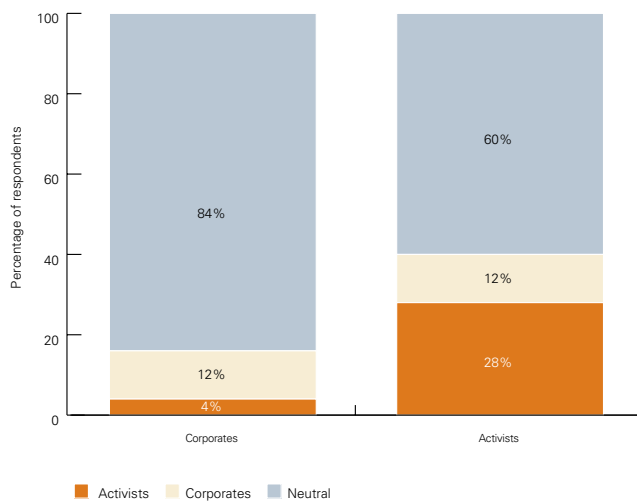
- The majority (67%) of corporate respondents believe the most effective defensive strategy a company can use against shareholder activism is maintaining an active dialogue with the shareholders themselves. Only 32% of activist shareholders agreed that this approach is most effective.
- Shareholder activists cited a much wider variety of defensive tactics companies can use against its activist shareholders. The creation of multi-class shares, the adoption of activist suggestions, and use of the poison pill method are each considered by 16% of activist respondents to be the most effective defense mechanisms.

- Corporate executives and shareholder activists largely disagree on shareholder regulations. Perhaps unsurprisingly, 79% of activists believe the SEC should adopt rules giving shareholders access to nominate directors in the company's proxy statement, while a significant 55% of corporate respondents disagree.

*“Often potentially active shareholders want primarily to know that their value-enhancement ideas have been seriously considered by the management and board of directors. Careful consideration of an activist’s proposals at the board level can also serve to weaken an activist’s potential director election campaign. Defensive tactics implemented after an activist arrives publicly on the scene can often backfire—the often influential proxy advisory services, in particular, tend to take a negative view of what they view as entrenchment activities.”*

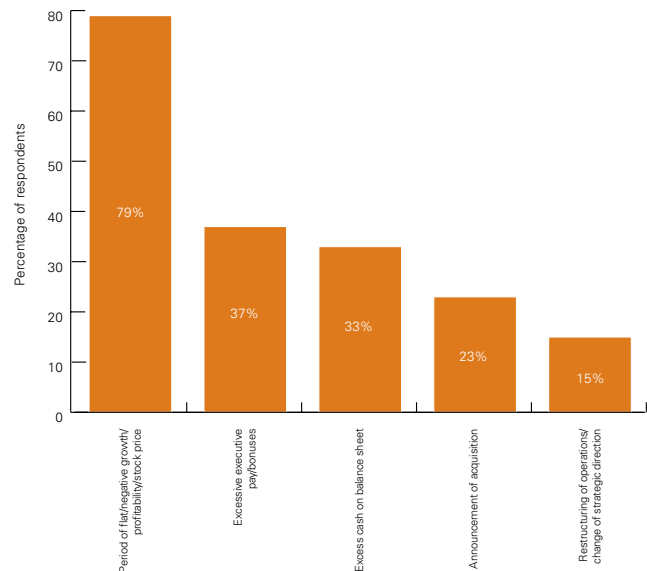
*David Rosewater, Partner, Schulte Roth & Zabel*

Who do you think will see the most positive impact from the newly adopted e-proxy rules?



- The overwhelming majority of each respondent group believes e-proxy rules will not influence corporations or their activist investors. One activist investor explained: "My initial thought is that no one gets the upper hand. It's how you get the message out there and the how the shareholders use their voices that counts." Still, it should be noted that more than a quarter (28%) of activists believe the new e-proxy rules will benefit them more than it will benefit corporates compared to only 4% of corporate respondents. A particularly optimistic investor explained: "Everyone wins. There will be more transparency between companies, shareholders and the media."
- The issue of e-proxy regulations sparked a wide variety of responses from each group, many of which pointed to the cost saving benefits. As one corporate respondent points out: "It saves a lot of money as hard copies were a great expenditure for us. It will be especially valuable to public companies." Others believe the rules have not yet revealed their impact, with a corporate respondent saying that "the jury is still out" and an activist investor saying: "It will take a while for the e-proxy rules to take effect."

Which catalysts do you believe would cause a shareholder to go active?



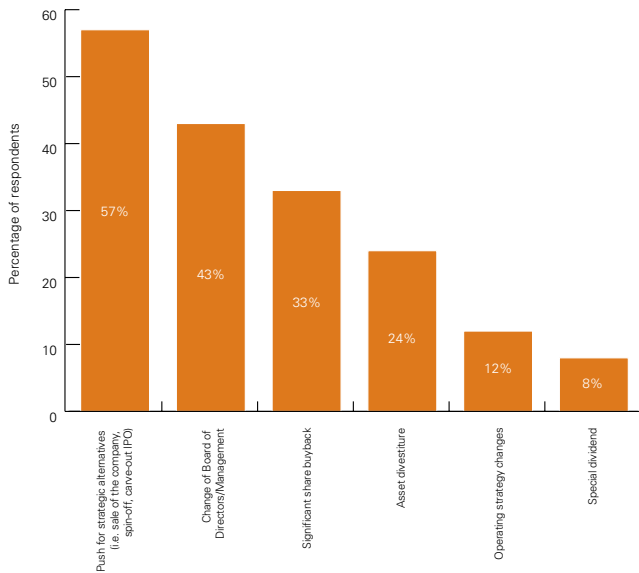
- 79% of overall respondents agree that a period of flat or negative growth, profitability or stock price can drive a shareholder to go active. Respondents from both groups pointed to other factors as well. One corporate respondent explained that shareholders tend to go active if they believe a company is not doing all it can to maximize shareholder value: "Any shareholder who believes that opportunities to drive shareholder value are not being properly pursued or executed is likely to go active."
- 46% of corporate respondents and 28% of activist shareholders believe excessive corporate salaries are a major catalyst to shareholder activism. Interestingly, this was the only factor that received significantly different responses from the two groups.

*"Not surprisingly, both constituencies believe that poor corporate performance is the principal catalyst causing a shareholder to go active."*

*Marc Weingarten, Partner, Schulte Roth & Zabel*

Study findings

*What proposals are most frequently used by activists to increase share price?*

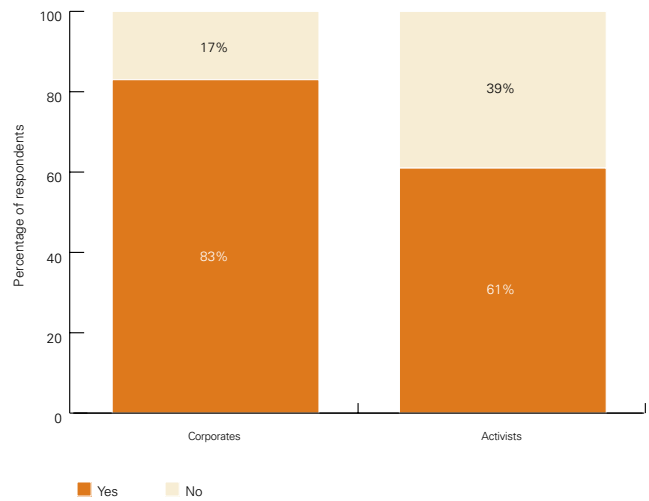


- 57% of overall respondents believe activists looking to increase share price most often push for strategic alternatives. Activists were particularly in favor of the method, as 71% of them said they use it frequently.
- There is a disparity between the two respondent groups in regard to management changes. Indeed, 67% of activists say activist shareholders looking to increase share price will push for management changes within the company, while only 23% of corporate respondents believe this method is used often.

*“One of the trends in activism we have seen in our practice is a rise in ‘operational activism’, particularly as the market environment has made popular strategies such as sale of the company or recapitalizations more difficult to execute.”*

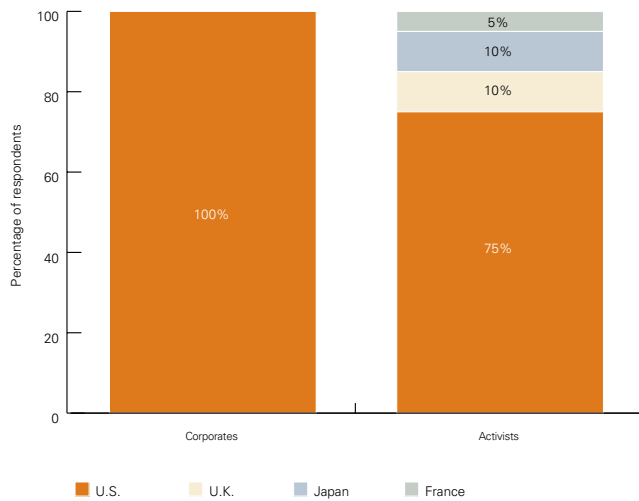
*David Rosewater, Partner, Schulte Roth & Zabel*

*Do you think the law should be changed to require activists to disclose their derivative/swap interests as they would their stock ownership even if they have no right to vote or call stock held by the counterparty?*



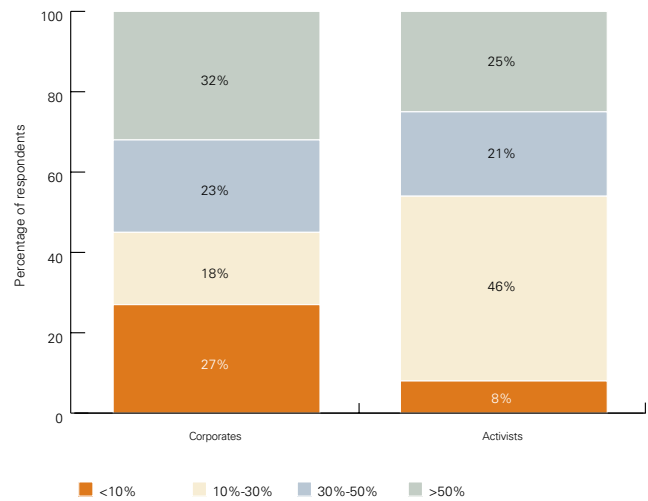
- Corporate respondents are most likely to believe activists should be required by law to disclose their derivative/swap interests, with 83% compared to 61% of activist respondents.

*In which country do you expect to see the greatest increase in activist investing in the next 12 months?*



- The U.S. is expected, by the majority of overall respondents, to see the greatest increase in activist investing in the next 12 months, with corporate respondents unanimously agreeing. Activists are more likely than corporate respondents to expect an increase in overseas activist investing. While 75% of activists agree that the U.S. will see an increase in activism, the remaining quarter expects an increase in the U.K., Japan and France in the upcoming year.

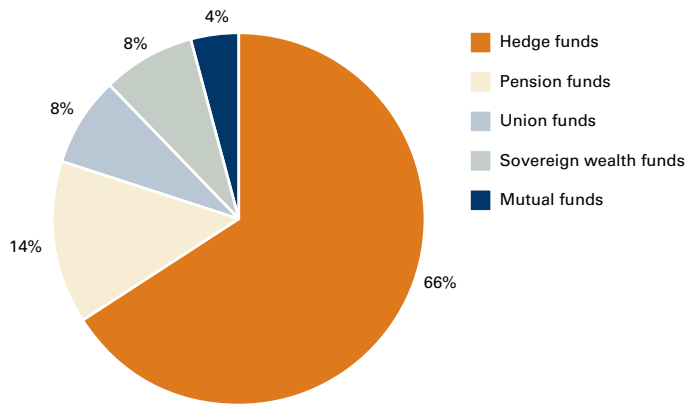
*What percentage of the time do activist investors and corporates work together cooperatively and the general public never hears about it?*



- 55% of corporate respondents and 46% of activist investors believe the relationship between executives is cooperative more than half of the time. Still, more than a quarter of corporate respondents (27%) believe cooperation occurs less than 10% of the time, compared to only 8% of activist respondents.
- The feedback from corporate respondents suggests that the complex relationship between company executives and activist shareholders makes it difficult to quantify the cooperation issue. One corporate respondent pointed out that activist investors are often “opportunists aimed at creating turmoil”, while another argued that it was a “mistake to say all activists are short-term investors.”

Study findings

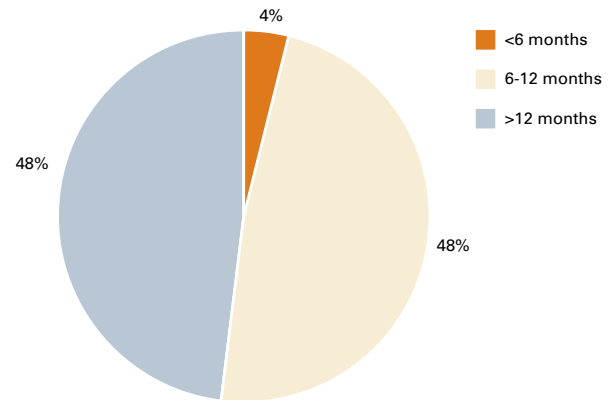
*Which buy-side investors do you expect to increase their activism the most in the next 12 months?*



- 66% of respondents expect to see an increase in activist investments from hedge funds in the year ahead, more than any other buy-side investors. Apart from hedge funds, respondents were somewhat divided between pension funds, union funds, sovereign wealth funds and mutual funds. One activist noted the reason for this break-up of perspectives: “Percentage wise it is pension funds, but in terms of absolute numbers it would be hedge funds.”

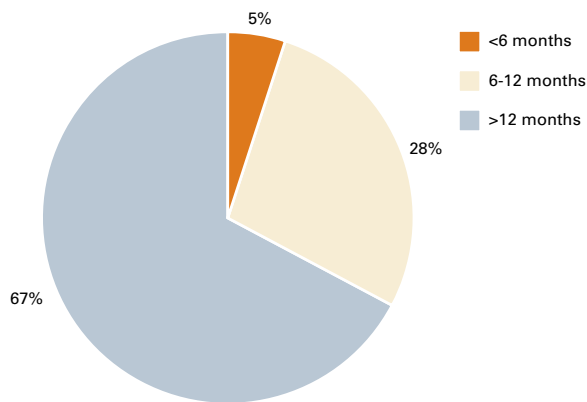
**Activist respondents only**

*For stocks which were originally passive investments but become active, how long do you typically own the stock as a passive investor?*



- Although one corporate respondent described activism as “a way for short-term investors to make money”, many activist investors are invested in the company for over a year before they become active. Nearly half (48%) of activist investors say they typically own the stock for a year or more before it becomes active.

What is the average holding period for an activist investment?

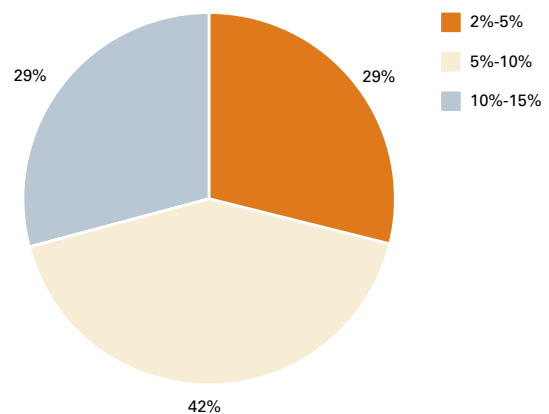


- Given the broadly held view that activist investors are typically short-term investors, it is interesting that the largest percentage of respondents (67%) hold on to their investments for a year or more. More than a quarter (28%) say the holding period falls between six months and 12 months, while only the remaining 5% believes an average holding period is less than six months.

*“Contrary to the ‘short-term’ perception, almost half the activists hold stocks for more than a year even before going active, and over two-thirds hold their activist positions for more than a year.”*

*Marc Weingarten, Partner, Schulte Roth & Zabel*

What percentage of assets under management are you most comfortable committing to an activist investment?



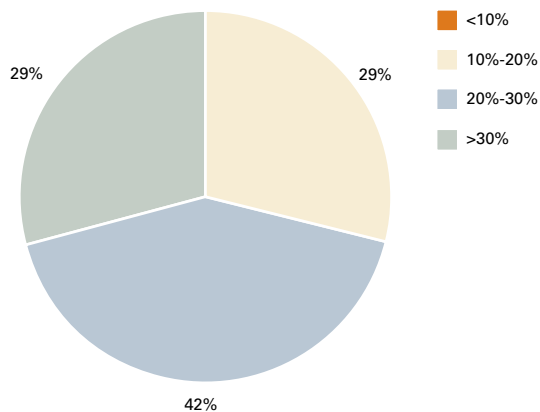
- Activist investors vary widely regarding the commitment of assets under management. The largest portion of respondents (42%) are comfortable committing between 5% and 10% of assets under management, while an equal 29% say they are comfortable committing between 2% and 5%, or between 10% and 15%.

*“Recently we have seen a rise in the making of highly concentrated activist bets; it remains to be seen if a bear market period will significantly affect or eliminate this trend. Investment concentration has the potential to affect the intensity of an activist campaign.”*

*David Rosewater, Partner, Schulte Roth & Zabel*

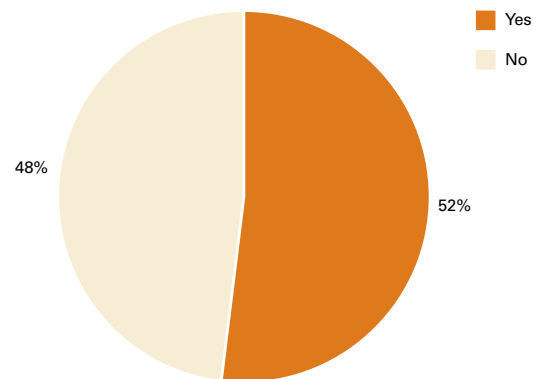
## Study findings

*What annual returns do you target in activist investments?*



- As in the previous question, activist investors do not have a common target when it comes to returns on investments. Some 42% say they target between 20% and 30%, while the remaining respondents are evenly divided between targets of more than 30%, and targets between 10% and 20%. Not surprisingly, no respondents target returns less than 10%.

*Do you believe corporate boards generally are proactive in seeking to maximize shareholder value?*



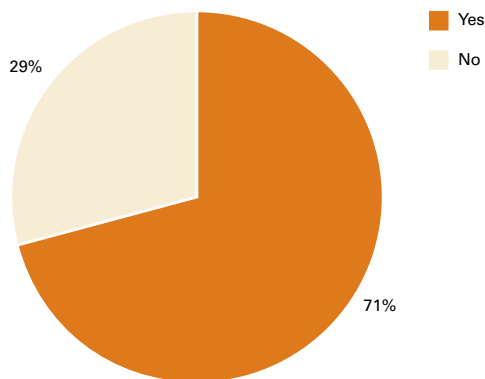
- Activist respondents were nearly evenly split between those who believe corporate boards are proactive in maximizing shareholder value and those who believe corporate boards are passive in this respect. Interestingly, one corporate respondent had actually pointed out that it is the inaction of companies that often sparks shareholder activism: "Shareholders who believe opportunities to drive shareholder value are not being properly pursued or executed by a company are much more likely to go active."

*"It can't be emphasized enough that the best weapon a board has against a potential activist is to proactively and regularly consider all potential strategies for maximizing shareholder value; as with structural defensive tactics, proxy advisory services can take a dim view of boards that consider certain alternatives or operational strategies only when forced by an activist."*

*Marc Weingarten, Partner, Schulte Roth & Zabel*

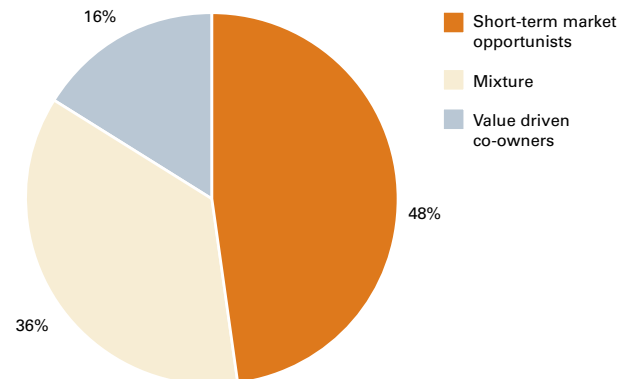
## Corporate respondents only

*Do you believe it is appropriate for shareholders to have board representation?*



- In regard to board representation, the majority (71%) of corporate respondents believe it is appropriate for shareholders to sit on corporate boards. Still, more than a quarter (29%) consider shareholder board representation inappropriate.

*What is your overall impression of activist investors?*



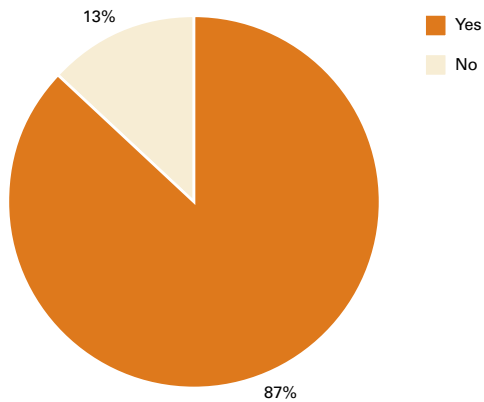
- There is no majority opinion among corporate respondents regarding activist investors. The largest percentage of this group (48%) however views activist investors as short-term market opportunists. The smallest percentage (16%) believes activist investors are value driven co-owners, while more than a third (36%) do not group activist investors into a single category.
- One corporate respondent supported his unfavorable view of activist investors by highlighting their negative influence: "Many are opportunists that damage companies by creating turmoil." Other executives acknowledged the difficulty in categorizing activist shareholders: "They are misunderstood. Many prove to be long-term investors, but there is a tendency to lump all activists together, which is a mistake." Another agreed, adding: "Many are just opportunists. But some companies do need a bit of probing."

*"There is clearly a continuing wide gulf in the views of companies versus activists of the appropriateness of activists' engagement and involvement with the company about its strategy. As a result, it seems likely that contentious contests will continue for the foreseeable future."*

*David Rosewater, Partner, Schulte Roth & Zabel*

## Study findings

*Do you believe activist investors can be effective in enhancing shareholder value?*



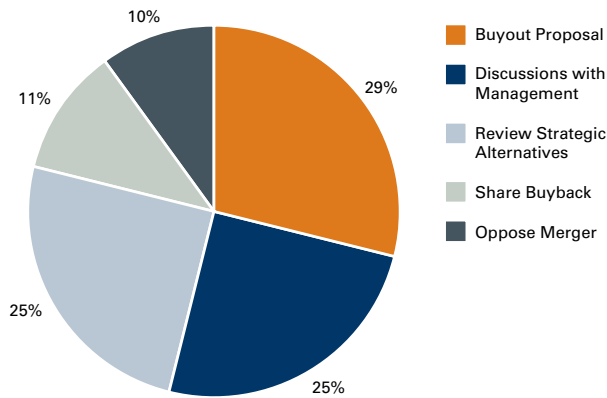
- Although in the previous question nearly half of corporate respondents viewed activists as opportunists, a remarkable 87% of corporate respondents still agree that shareholder activism can enhance shareholder value. Indeed, many corporate respondents explained that activism has the potential to keep companies in line. One respondent explained: "They keep us on top of our game."

*"Eighty-seven percent of corporate executive respondents believe that activist investors can be effective in enhancing shareholder value, notwithstanding that almost half see activists as short-term market opportunists."*

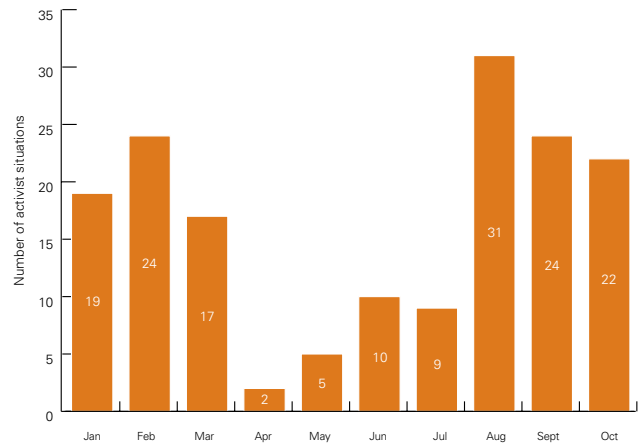
*Marc Weingarten, Partner, Schulte Roth & Zabel*

# Historical data

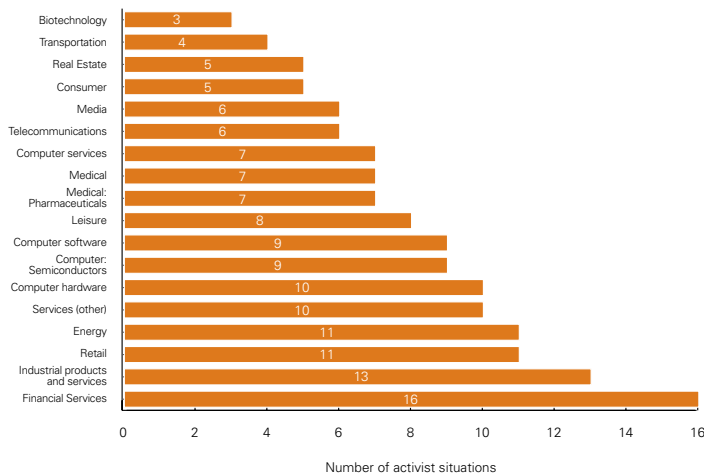
Activist investor demands



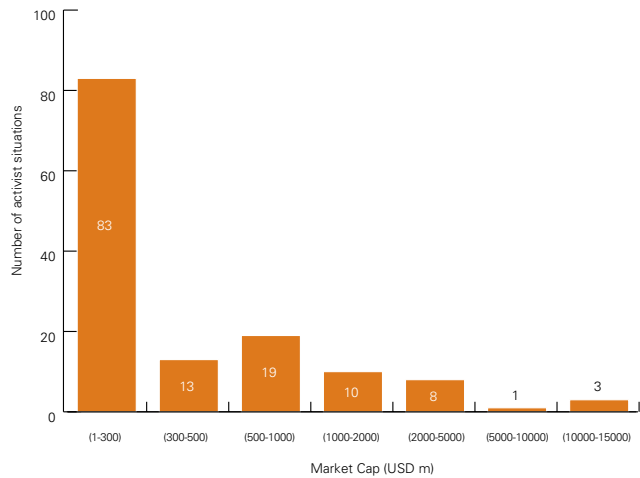
Activist investor activity per month



Activist situation by sectors



Size of Activist Situations



Source: dealREPORTER

All data collected is to the end of October 2008

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## About Schulte Roth & Zabel LLP

Founded in 1969, Schulte Roth & Zabel has grown to more than 470 attorneys whose primary focus is delivering sophisticated, leading-edge advice to the firm's clients, which include prominent institutions, corporations and investors. The firm strives to build and maintain long-term relationships with clients by emphasizing client service. With expertise in a broad array of practice areas, the firm provides comprehensive advice to achieve its clients' objectives.

SRZ is one of the leading law firms in the area of business transactions, including mergers and acquisitions, leveraged buyouts, special opportunity investments, activist matters, public offerings, high-yield debt issues and PIPE transactions. Clients include both financial and strategic investors.

The firm has a preeminent practice specialty in activist investing, with unparalleled expertise in the applicable securities laws and proxy rules, and the current state of market practice. SRZ has been counsel in many of the highest profile activist matters in recent years.

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French M&A and Private Equity Forum.....	Paris, March/April
Russian M&A and Private Equity Forum.....	Moscow, April
Debtwire Distressed Debt Forum.....	New York City, April
Italian M&A and Private Equity Forum.....	Milan, May
Nordic M&A and Private Equity Forum.....	Stockholm, May
Spanish M&A and Private Equity Forum.....	Madrid, May
European M&A and Private Equity Forum.....	London, June
Brazilian M&A and Private Equity Forum.....	São Paulo, August
Australian M&A and Private Equity Forum.....	Sydney, August
German M&A and Private Equity Forum.....	Cologne/Bonn, September
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Canadian M&A and Private Equity Forum.....	Canada, October
Benelux M&A and Private Equity Forum.....	Amsterdam, October
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