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How shareholder activists create value:

Overview and impact of their different strategies

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Executive Summary

Whereas institutional activism is performed by passive investors that seek to support their portfolio's underperforming firms, this thesis focuses on hedge fund activists, who deliberately purchase a minority stake in a company and try to implement their vision or strategy to improve the company's performance and generate abnormal returns. In the last decade, this form of activism has received much more media attention, with activists deploying a record of $65 billion of additional capital in 2018. Moreover, activists historically targeted small to medium-sized U.S. firms; however, recent growth is mainly driven by new campaigns in Europe, Asia, and Australia with targets becoming larger and more complex than ever before, leaving no company immune to activism.

Even though shareholder activists only purchase small, non-controlling stakes, they often manage to impose their new vision and strategies on targeted firms through the use of several tactics. Prior to implementing their changes, activists need to find targets that will benefit from their intervention. Several company characteristics increase the likelihood of attracting hedge fund activists. Indeed, similarly to companies targeted by private equity investors, underperforming businesses often attract activists that want to push the firm back to normal or higher performance levels. Other attractive target-related criteria include companies trading at a conglomerate discount, firms with a poor capital structure, bad governance practices such as extravagant executive pay or inappropriate board members, lacking a clear business strategy, poor ESG ratings, and companies involved in M&A transactions.

Once activists have selected a new target, they initiate a campaign to convince the management to implement their changes. The tactics used vary greatly depending on the type of campaign, the aggressiveness of the hedge fund, and the reactions of the different stakeholders and the market. A campaign often starts by demanding peaceful private or public negotiations with the management and the board of the firm in order to reach a painless settlement agreement. Next to a compromise on the strategical changes suggested by the hedge fund, activists often require to appoint directors at the board to maintain their influence. If friendly negotiations do not lead to an agreement, activists will likely resort to the more expensive proxy contest in which other shareholders will be asked voting on the activists' proposal. An even more aggressive option for activists is to initiate a lawsuit against the company in order to remove poison pills, obtain access to shareholder-specific information or impose their changes. Recently, some large activists even resorted to hostile takeover bids by cooperating with private equity funds to gain full control of the targeted firm.

Activists' path to influence can become very expensive if the conflict between the firm and the hedge fund escalates. Indeed, if no settlement agreement is reached following the negotiation phase, a campaign ending up in a proxy contest costs, on average, as much as $10 million. Moreover, as the targeted firms also face consequences such as management distraction from the core operations, high costs in responding to the activist, and the negative impact on employee morale, managers should prepare by addressing issues that could attract activists as well as establishing a clear response plan if an activist enters the shareholder base. Indeed, since activists often have good ideas that can lead to better performance, cooperation can be beneficial to both parties.

Activists often claim that their strategical changes generate both high short-term and long-term value for the targeted firm's shareholders. Research almost unanimously supports the short-term value creation linked to activists' interventions, however, longer-term abnormal returns are often contested; analyses based on pre-crisis datasets tend to support the activists' overperformance, while post-crisis analyses are less conclusive. Moreover, while the literature extensively covers pre-crisis activism events, the number of studies based on post-crisis datasets is limited.

This paper analyses a dataset containing all the activism campaigns from January 2017 until September 2018 for targets with a market capitalisation higher than $500 million. Next to the recentness of the events, a major strength of this research is that the dataset contains global targets with the exact campaign announcement date even when the activist purchased a stake smaller than five percent. Indeed, most analyses only use U.S. datasets based on 13D filings, which are only required when acquiring a stake higher or equal to five percent.

This analysis confirmed the existence of a significant short-term overperformance of 2.6 percent, however, this overperformance disappears after approximately five months, casting doubts on whether activists really improve the long-term performance of companies. These results are further complemented by a review of the performance of the most prominent activist hedge funds in 2017 and 2018. Over the same period, most of the activists underperformed compared to their benchmarks, confirming these findings.

Furthermore, research suggests that the excess returns differ depending on the type of change implemented by the activist. This study breaks the different events down in seven major activists' strategies being reshaping the business strategy, activism against M&A transactions, changing the firm's corporate governance, appointing new directors to the board, targeting the management, improving the company's operations, and changing the capital structure. A last category contains the events where the activist did not specify any clear

campaign purpose. This analysis finds that activists generate higher abnormal returns and maintain these over a longer period when they address business strategy issues as well as M&A-related concerns. The worst performing strategies relate to targets where the activists are willing to change the management or lacking a clear strategy.

Further analysis finds that the size of the targeted firms as well as the stake purchased by activists also influence the excess return generated. Recently, activists started targeting larger companies, however, this paper's results show that the largest group of firms targeted, with a market capitalization exceeding $10 billion, generated less excess returns than their smaller counterparts. The stake purchased by activists also impacts the performance; in this analysis, activists acquiring more than 10 percent of the target show the highest excess returns. These results suggest that private equity techniques might continue to gain popularity among hedge fund activists with deep enough pockets.

This thesis contributes to the existing research by providing an updated view on hedge fund activism through the combination of existing literature with company reports, press releases, newspaper articles, and an analysis of activism events from January 2017 to September 2018. Moreover, this research also has practical implications. Indeed, it is crucial for senior management and board members to prepare for activists, understand their methods, and be ready to collaborate efficiently.

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Glossary

- AUM: Assets under management
- CAGR: Compounded Annual Growth Rate
- ESG: Environmental, Social & Governmental
- SEC: Securities and Exchange Commission
- CPG: Consumer Packaged Goods
- M&A: Merger and Acquisition
- ISS: Institutional Shareholder Service
- GL: Glass Lewis & Co
- P&G: Procter & Gamble
- ETF: Exchange Traded Fund
- GM: General Motors
- CIAM: Charity Investment Asset Management
- AGM: Annual General Meeting
- BU: Business Unit
- PEI: Power and Energy/Infrastructure
- FIG: Financial Institutions Group

Introduction

Shareholder activism (also referred to as hedge fund activism) has been around for several years but it has received much more media attention in the last decade. Press releases with titles such as “Shareholder Activism Is On The Rise: Caution Required” and “Shareholder activism is on the rise, but companies are fighting back” are suggesting that shareholder activism is something companies should pay attention to or even fight back (Ponomareva, 2018; DePillis, 2019). But should companies be so worried about shareholder activism? And what exactly is the impact of these shareholder activists? This thesis tries to answer these questions by reviewing existing literature, company reports, and press releases, as well as by analysing the financial impact of activist events of 2017 and 2018. The paper is structured in 3 major parts.

After an overview of the recent trends in the sector, the first part illustrates the road ahead of an activist’s campaign. It starts by analysing how shareholder activists choose a target. These selection criteria are crucial for managers in order to understand how to avoid an activists’ campaign. Next comes a review of the different steps used by activists during their campaign. Usually activists only have between 1 and 10 percent of the company’s voting power, yet, using tactics such as proxy contests, they still manage to influence the company’s stakeholders to implement their strategy and vision (Stowell, 2010; Brav, Jiang, & Kim, Hedge Fund Activism: A Review, 2010). This part concludes with a focus on how companies should anticipate activists, and, if targeted, how they can manage this, often challenging, new shareholder.

The second part of this paper focuses on the impact of shareholder activists as well as the different changes they bring to a target. It starts with a review of the literature regarding whether activist campaigns can generate short-term and long-term excess returns for the targets. Hedge fund activists are often criticised due to their short-term investments casting doubts on their long-term impact (deHaan, Larcker, & McClure, 2018). Next, the focus goes to the different strategical changes activists push onto targets and how these changes influence the generated returns. The different strategies discussed are changes brought to the target’s capital structure, improving governance issues regarding the company as a whole, the board, or the management, improving the company’s overall strategy or operations, and activism against or in favour of M&A transactions. To conclude on this second part, ESG concerns are covered with a focus on the environmental and social components.

The third and final part is an original contribution to the existing literature; it summarises and discusses the results of my analyses on the impact that hedge fund activists have on the stock price of their target. The literature contains multiple studies on the activist's performance, however, very little use a sample of post-crisis activist events. Hence, the analysis is based on a recent sample of 378 distinct activist campaigns from 2017 until September 2018. The first section deals with the data collection, the methodology, and descriptive statistics. The next section focuses on the results, where an important distinction between short-term and long-term impact is made. Indeed, most researchers support that activists have a positive short-term impact; however, no consensus is reached regarding the longer-term excess returns. Furthermore, I analyse whether the performance of the targets is influenced by the different strategies announced by the activist when they disclose their stake. Finally, before concluding this thesis, I review the strengths and weaknesses of my analysis and make some suggestions regarding further research opportunities.

Before we dig deeper into the subject, it is important to clarify what shareholder activism is and which type will be discussed in this paper. Shareholder activism has been defined by the international law firm Sullivan and Cromwell (2019) as "the practice of purchasing an issuer's shares with the primary intention of influencing the corporate strategy or governance of the issuer". Hence, shareholder activists are different from traditional institutional investors as they use their shareholders' rights to impact the decision-making process of the company. They also differ from private equity investors as they target both public and private companies and take a minority shareholder position in the target. Moreover, stakeholders taking active part in the decision-making of a company without taking a shareholder position are not considered shareholder activists, hence, vulture funds and other investors investing in securities without voting rights will not be regarded as shareholder activists (Amour & Cheffins, 2009).

The rise of shareholder activism finds its roots back in the mid-1980s. As Denes, Karpoff, and McWilliams (2017) suggest, this period coincides with the moment institutional funds started to replicate stock index returns. These funds could not sell underperforming firms from their portfolio anymore, hence, they engaged in some sort of activism activity to increase the firms' performance. This type of passive activism is increasingly used by long-term investors and is sometimes referred to as "shareholder engagement" (PwC, 2015). Activists covered in this thesis are different; instead of waiting until some of the firms in their portfolio start to underperform, they proactively search for targets that would benefit from activism, take a long position in these companies, and become active (Kahan & Rock, 2009). This type of activism is usually performed by hedge funds, which are more aggressive and short-term oriented than the passive activists (Amour & Cheffins, 2009).

Shareholder activism trends

Shareholder activism activity has never been as high as in 2018 with as much as $65 billion of additional capital deployed, compared to only $30 billion in 2016 (Lazard, 2018). This increase led to a total of $300 billion assets under activists management in hands of multiple players in the industry with the largest activist Elliott Management handling almost $34 billion assets (Deloitte, 2018; Elliott Management, 2019). The number of companies publicly targeted by activists has increased from 607 in 2013 up to 922 in 2018, representing a CAGR of 9% (Activist Insight, 2019). Retail and institutional investors are increasingly looking for opportunities to invest in shareholder activism hedge funds; in 2017, Elliott Management raised more than $5 billion in less than 24 hours for new activist investments (Delevingue, 2017). In an interview, Bruce Goldfard, CEO at activist fund Okapi Partners, suggested that the growing popularity of shareholder activism is due to the increased volatility in the markets. The higher volatility leads to more underperformers, and hence, more targets that can benefit from activist interventions (CNBC, 2018). The increasing number of activism events is also driven by multiple activists targeting one same company. In 2018 13 percent of the U.S. targets were confronted to more than one activist, up from only 6 percent in 2016 (J.P. Morgan, 2019).

Activism originates from the United States; however, recent growth is almost entirely driven by new targets in Europe, Asia, and Australia. Back in 2012 fewer than 30 percent of the reported activism cases originated out of the United States, while this number increased to almost 50% in 2018 (J.P. Morgan, 2019). This surge in international activism is partly due to strong stock performances in the United States, pushing activists to research other markets (Activist Insight, 2019). Within the markets out of the United States, the countries with the highest activist activity are the United Kingdom, Japan, and Hong Kong. Internationally, activists tend to focus more on large capitalisation than they do in the United States (J.P. Morgan, 2018).

This trend towards an increasing number of large companies being targeted is not only true for Europe and Asia but also for the United States. Activist Insight (2019) reports that activists are increasingly targeting companies with powerful defences such as private companies, companies with very concentrated shareholders, as well as large companies. Moreover, activists increasingly target strongly performing companies such as Apple and McDonald's (Whitten & Singh, 2015). Shareholders daring to engage more complex targets is driven by the growing trust and support given by pension funds and other hedge funds. These institutional investors, who originally defended the management, increasingly back-up activist investors that try to gain influence on a company present in their portfolio (Toonkel & Soyoung,

2013). Next to targeting all types of companies, even the more complex ones, activists also target all the different types of sectors. Their preferred industries are financial services, consumer goods & retail, and energy (Deloitte, 2018).

Shareholder activists' aims can be separated in two broad categories: financially motivated activism and socially motivated activism (Judge, Gaur, & Muller-Kahle, 2010). Judge, Gaur, & Muller argue that financially motivated activism occurs when the activist perceives the company to be sub-optimally managed. The activist will then try to launch initiatives or strategies to bring the company back to a competitive position. These strategies will be further discussed in the second part of this analysis. The second main reason to start a campaign is socially motivated activism, which is set to be the next big thing according to Activist Insight (2019). Indeed, with the evolution of the ESG reporting standards to the global GRI Standards in 2018 and the raising ecological concerns among investors, ESG becomes an increasingly important investment decision criterion. Hence, shareholder activists increasingly target companies to improve social and environmental issues (Hoepner, Oikonomou, Sautner, Starks, & Zhou, 2018).

Part 1: Shareholder Activists and their Targets

Introduction

How can small shareholders end up having a tremendous impact on some companies? The impressive changes driven by shareholder activists are often praised in the newspapers, however, the path to control is not an easy one and requires a big investment in time as well as money (Gantchev, 2013). Prior to implementing their new vision through a set of different strategies, activists first need to identify a promising target that will benefit from their intervention. Predicting which companies will be targeted is difficult, however, targets often share similar characteristics (Foldesy, DiGrande, & Olsen, 2016).

Next, activists need to reach a certain level of influence to implement their vision and strategy. In order to do so, they have different tactics, such as shareholder proposals and the possibility to launch a proxy fight, with varying levels of coercion and pressure. In the following section, the activist's campaign to achieve influence at a target firm is divided into different stages based on papers from Gantchev (2013), Lio, Varma, & Veerarghaven (2016), and a report from PwC (2015). The first step in an activist's campaign is to demand negotiations, the activist usually seeks to privately or publicly communicate with the different stakeholders of the target to share his vision and better understand the situation. Next, the activist will likely require to appoint a director to the board. If no settlement agreement is reached, the activist might launch a proxy fight, seeking a majority of votes in order to impose his vision to the target firm. Finally, in some rare cases, the activist can use more aggressive tactics such as filing a lawsuit or making a hostile takeover bid to force the changes on the company.

When an activist launches a campaign against an unprepared company, it takes a lot of time from the management, it can come with high costs if a proxy contest is initiated, and the employee morale can take a dip. Hence, the last section focuses on how companies should best prepare for activists, and, if an activist initiates a campaign against the firm, how they should manage him.

1. Target selection

Are all the companies as likely to be targeted by activists? The simple answer is no. There are multiple factors that have an impact on the attractiveness of a potential target for activists. A common aspect with other investors is that shareholder activists are interested in the potential returns their investment can generate. As such, they will first look for undervalued companies

based on a range of different valuation methodologies such as market value, liquidation value, etc. (Olstein, 2009). Value screening is an important part of the process, activists review thousands of companies to find a few targets (Park, 2016). In order to determine the market value of a potential target they will use traditional techniques such as ratio analysis focusing on the price-to-book ratio, price-to-earnings ratio, price to free cash flow ratio, and many others. If the stock price of these undervalued companies happened to strongly increase due to the activist's purchase announcement or management initiatives, shareholder activists could be satisfied and sell (Amour & Cheffins, 2009). The main difference between shareholder activists and other shareholders are the steps after the purchase of a stake in the company. Once traditional investors identified an underperforming company, they are likely to wait until the market value of their asset meets their expectations, however, shareholder activists will actively promote their plan to create additional value for the company's shareholders. Hence, target selection for shareholder activists goes beyond the traditional investment criteria of undervaluation.

Other financial metrics that are not linked to target valuation are also crucial to determine whether a target is appropriate or not. A first important factor is the total market capitalisation of the target (Park, 2016). Typically, hedge fund activists acquire between 1% and 10% of the shares (Stowell, 2010; Brav, Jiang, Partnoy, & Randall, 2008). Hence, depending on the financial means of the activist, different firms will be targeted. According to Activist Insight's report (2019), in 2018, 65% of the investment made were targeted at companies with a market cap under $2 billion. Indeed, acquiring a sizeable stake in smaller capitalisation firms is cheaper than for larger caps. These smaller cap firms' stocks are often less liquid, increasing the probability for these shares to trade at a discount compared to its intrinsic value. Hence, these stocks can be bought cheaply by activist investors and with the adequate actions, can be turned into competitive and more expensive shares (Park, 2016). Yet, representatives of large activist hedge funds such as Elliott Management and Cevian Capital, state that larger cap targets are becoming more common (Mace, 2018). Indeed, these larger caps can sometimes diversify their portfolio to an extent that creates conglomerate discounts (Ammann, Hoechle, & Schmid, 2012). Recent examples include Third Point LLC targeting Nestlé to enhance its strategy as well as divest parts of the business (Third Point, 2018) and Trian Partners acquiring Procter & Gamble shares to initiate a company reorganisation (Colvin, 2018). Investments in firms with a market cap higher than $2 billion slightly increased from 34% in 2017 to 36% in 2018 (Activist Insight, 2019).

This conglomerate discount is directly linked to the next investment criteria shareholder activists might be looking for. Indeed, companies having multiple business units that do not

generate the required synergies, or worse, that create dis-synergies, are likely to be targeted by activists. Park (2016) presents this as the sum-of-the-parts analysis. Management often hesitates to divest non-core business units for multiple reasons such as the negative impact on their revenue, the time it takes and the team mobilisation it requires, the idea of being at the head of a smaller company is less attractive, etc. (Wininger & Rujana, 2017). This is where activists can play an important role by convincing other shareholders that the individual parts have a higher value than the conglomerate as a whole. The same reasoning can be applied when activists enter a company to oppose an M&A deal. M&A activism has been the focus of activists for the last two years, pushing for the sale of an asset, trying to obtain a higher deal price or completely blocking a potential transaction (Grossman & Warrick, 2019). Firms in one of these situations are more likely to be targeted by shareholder activists. However, since M&A-related activism is directly linked to the strategies implemented by shareholder activists, it will be further discussed in Part 2.

As shareholder activists want to influence the company's governance or strategy, another crucial investment aspect is the perceived feasibility to implement their vision (Hinkel, Poppe, Toner, & Whitten, 2015). In other words, the activist must believe that the target will accept his action plan to create value. The process of convincing the target firm to accept their propositions often requires the support of other shareholders. Indeed, activist shareholders usually only acquire a minority stake in their target firms (Katelouzou, 2013). As public firms in the United States are owned for more than 70% by institutional investors (Medcraft, 2018), they have a tremendous impact on hedge fund activists. Historically institutional investors were reluctant to shareholder activists as they often had conflicting agendas (Bainbridge, 2005). Bainbridge also states that activism can undermine the role of the board of directors leading to less efficient corporate governance. However, the relationship between activists and institutional investors has evolved over time. Institutional investors that were previously passive about their investments have become more active and are willing to support activist investors in their campaigns, both publicly and behind-the-scenes (Weinstein, de Wied, & Richter, 2019; Kedia, Starks, & Wang, 2016). Hence, the relationship between the shareholders of a target and the activists is an important factor influencing the target's attractiveness. Carrothers (2017) confirms that firms with high levels of institutional ownership are more likely to attract shareholder activists. Moreover, he also identified that activists prefer institutional investors that are short-term oriented to match their investment time horizon. According to Carrothers (2017), on average, activists hold their position in a company for 1.8 years, which is in line with the investment horizon of 1.6 years for short-term institutional investors, however, other researchers such as Brav, Jiang, Partnoy, and Randall (2008) find a shorter holding period of 1 year for an average campaign. As activists often strengthen their

position in the company after the initial investment phase, this short-term investment horizon ensures a higher liquidity for the activist (Brav, Jiang, Partnoy, & Randall, 2008). Carrothers (2017) argues that, as activism generates both long-term and short-term abnormal returns, institutional investors with a longer investment time horizon could also be supportive to activists. These investors are able to better assess the value creation potential of the shareholder activists' plans.

Capital structure is also an important investment criterion for shareholder activists. Indeed, the capital structure impacts the company's operating cashflow and the weighted average cost of capital, hence, impacting the total market value of the firm (Goedhart, Koller, & Rehm, 2006). Activists are more likely to target firms with a constantly high cash position than others (Khan, 2013). In current market conditions, this excess cash does not generate any returns, hence, initiating share buybacks or increasing shareholder payouts are strategies often put in place by activists (Coffe & Palia, 2015). Other capital structure related activism focuses on initiating change at firms with excessively complex capital structures and inappropriate leverage (Deloitte, 2018). Certainly, low levels of debt are appealing issues for shareholder activists (Foldesy, DiGrande, & Olsen, 2016).

Closely related to capital structure issues is a weak corporate governance, which can often be an activist's motivation to target a firm. Shin (2016) demonstrates that when takeover defences such as poison pills are put in place by companies hindering the market for corporate control, activists are more likely to intervene and demand the removal of these defences. Shin (2016) also notes that dual-class structures and staggered boards can discourage activists. However, Activist Insight (2019) points out that dual-class structures, companies with high insider ownership and staggered boards were increasingly targeted in 2018. Moreover, it is important to have independent board members and directors (Aon Hewitt, 2016). The board composition should meet today's standards regarding tenure, board renewal, industry experience, and diversity (PwC, 2018). Indeed, board diversity is crucial on aspects such as skills and experience but also regarding gender (Nash & Freeman, 2017). The ideal board tenure is challenging to find; however, poorly balanced board tenures have proven to be less successful than others, leading shareholder activists to act (Papadopoulos, 2019).

Another corporate governance issue arising at most targeted firms is the excessive executive compensations that does not stimulate long-term performance (Olstein, 2009; Aon Hewitt, 2016). However, Haggerty (2017) points out that CEO pay is often used as a lever to convince other shareholders to back their agenda that focuses on obtaining board seats, changing the top management or changing the corporate strategy.

Indeed, an unclear or poorly understood strategy is often a reason for shareholder activism to get involved with the target (Wachtell, Lipton, Rosen & Katz, 2016). Strategy implementation is as important as strategy development, companies should develop clear strategies and communicate with transparency to avoid activists (PwC, 2015). Almost 50% of the large activist campaigns from 2014 to October 2018 demanded a review of the business strategy from the target (Deloitte, 2018).

Some countries or regions have historically been more targeted by shareholder activists. Indeed, as activism has its roots in the United States, originally most of the firms targeted were U.S.-based companies. In 2011 more than 75 percent of the shareholder activist campaigns were held in the U.S., however, the landscape today is entirely different. In 2017 the U.S. represented only 48 percent of global activism activity; this drop is mainly driven by the increase in non-U.S. campaigns (J.P. Morgan, 2018). Nowadays, activists are present in America, Europe, Asia, and Australia, with most of the international campaigns held in the UK, Japan, and Hong Kong (Activist Insight, 2019). According to an interview with Malcolm McKenzie, managing director at Alvarez & Marsal, the most challenging part in entering a new geography is adapting to its culture and local market regulation; however, in recent years, this challenge has been mostly tackled for all developed countries. Hence, nowadays, no firm is entirely immune to shareholder activism anymore.

Next to countries, some sectors are more likely to be targeted than others. However, similarly as for regions, all the sectors are exposed to the risk of being targeted by shareholder activists. According to Lazard's (2019) report, the sectors that are most likely targeted by activists are the industrial sector, the financial sector, the consumer sector, the energy sector, and the technology sector. Together, these sectors represent up to 70% of all the public activism events of 2018.

Gender seems to be another common characteristic of companies targeted by shareholder activists. In their study performed on a dataset of 2,079 hedge fund activism events orchestrated by more than 500 hedge funds from 2003 to 2014 Francis, Shen, and Wu (2017) show that companies led by female CEOs are 54% more likely to be targeted than their male counterparts. They hypothesise that this phenomenon could be due to the differences in company fundamentals between male and female-led companies. A second reason put forward by Francis, Shen, and Wu (2017) for this gender preference is that female CEOs tend to be less defensive and more open to communication and collaboration. The latter is crucial for shareholder activist as women CEOs are more likely to collaborate with them, leading to a smoother and less expensive campaign. One must note that the paper is still in a preliminary

phase and that it is the only paper analysing the relationship between activism and gender, however, the large sample size and the extensive literature used help to support this.

Last but not least, environmental, social and governmental (ESG) concerns often draw the attention of activist shareholders. Governance matters, previously discussed in this paper, have long been the focus of activists and remain the most important aspect of ESG for activist (Valentini, 2018). Recently, environmental aspects have gained importance among investors (Taylor, Millar, Cockrell, & Godrich, 2018). Indeed, investors are increasingly recognising the benefits of good ESG practices from firms in their portfolio, hence, pushing activists to adapt their strategies. An issue that arises when activists are focusing on ESG investment criteria is the investment horizon; ESG creates more stability for investors but requires on average longer holding periods (Devine, 2018). These holding periods are often not in line with hedge funds current practices, leading to some trade-off between ESG and time horizon.

However, when looking at prominent hedge fund activists' recent moves, ESG trends and concerns become clear. Trian Partners, started to provide ESG highlights for the most recent assets present in its portfolio (Trian Partners, 2019). Jana Partners closed two funds to open new ones later this year, among which a new impact-investing hedge fund expected to be called Jana Impact Capital (Williamson, 2019). Blue Harbour Group also emphasises the importance of ESG on its website through a dedicated tab (Blue Harbour, 2019).

This practice goes beyond a mere communication on their website, Jana Partners partnered up with CalSTRS and targeted Apple. Together, they requested to act up on the overuse of devices among the youth (Lipton & Podolsky, Activism: The State of Play, 2018). Hedge funds that are not specially known for their activism also increasingly support ESG campaigns, for instance, Vanguard discusses climate risk with its portfolio companies (McGrath, 2017). Activist Insight (2019) acknowledges ESG as a topic of rising importance for activists, however, it remains cautious as to whether it really is something activists will focus on in the future. Indeed, activists opting for ESG campaigns might only be doing this to try to enhance their public relations reputation. However, less sceptical activists mention that firms with good ESG practices can improve returns and outperform their competitors. Moreover, ESG campaigns are more likely to be supported by proxy advisors leading to quicker and less costly campaigns, ultimately increasing the activists' returns. Institutional Shareholder Services, the largest proxy advisor, released a report stating that the advisor supported activists in 45 percent of cases relating to ESG campaigns (Valentini, 2018). Next to the support of proxy advisors, activists also need the support of the largest shareholders of the targeted firm, which increasingly value ESG improvements (Kilroy, 2018). Hence, firms with lower scores on ESG matters are more likely to be targeted than their peers performing better.

To sum up, there are several common characteristics among the targets of shareholder activists. Several criteria such as financial ratios to approximate a target's value, ESG scores, sectors, and geography are used by both traditional investors and hedge fund activists. However, activists go a step further, they thoroughly analyse and identify problems in the company's strategy, its governance, the capital structure, executives' salaries, and the M&A activity impacting the target and then try to change these to create additional shareholder value. Hence, some companies are more likely to be targeted by activists, however, recently activists target even more complex companies that do not answer the traditional activists' checkbox.

2. Steps and tactics to influence

This part making several references to regulations, it is important to note that they can differ by region. As, in 2018, the United States accounted for 53% of global activism events, regulations will be discussed for the U.S. (Activist Insight, 2019).

Hedge fund activists, private equity funds, and management buyout by leveraged funds have similar approaches when taking a long position in a target firm. The main difference is the capital deployed; activists usually do not take a majority stake in the target, hence, deploying less capital (PwC, 2015), (Mietzner & Schweizer, 2014). Usually shareholder activists purchase between 1 and 10 percent of a company's shares (Stowell, 2010; Brav, Jiang, & Kim, Hedge Fund Activism: A Review, 2010), while private equity funds and leveraged buyout funds try to acquire the target to impose their changes. Activists, as minority shareholders, cannot directly impose their changes; as mentioned by the co-founder of an advisory firm Statera Partners, Michael Henson, "influence does not entail control", hence, they need other tactics to convince the shareholders and management to accept their vision (Fortado & Massoudi, 2019).

Once activist investors have determined which company they want to target, the specific changes they want to implement, and the outcome they aim to reach, they purchase a minority stake in the firm and inform the different stakeholders (GA de Bakker & Den Hond, 2008). Indeed, the U.S. Securities and Exchange Commission imposes to all companies acquiring 5% of a company or more to file a beneficial ownership filing (U.S. Securities and Exchange Commission, n.d.). Investors acquiring such a stake in a company with the aim to influence the management are required to submit a Schedule 13D filing within 10 days after the purchase. This filing is shared with the company and all the exchange where the security is traded to inform existing and new investors of whom are the largest shareholders and what their ambitions are. Investors must clarify whether they plan to launch a hostile takeover, to acquire the target, or want a proxy battle. An alternative filing is the Schedule 13G, which is a similar filing for passive investors with a stake in the target equal or higher than 5% containing fewer reporting requirements.

The next step is when activists promote their agenda to drive change at the targeted company. The tactics used vary greatly depending on the type of campaign, the aggressiveness of the hedge fund, and the reaction of the target, the shareholders, and the market (PwC, 2015). Lio, Varma, & Veeraraghavan (2016) provide an overview of the typical steps and tactics used by activists to exert influence over the different stakeholders of a company. Activists usually start with private discussions with the management and collect information about the management

and the board. Next, they will launch media and public relations campaign to put pressure on the board and attract other like-minded shareholders or investors. This part is likely accompanied by public statements and presentations (also called white papers) to illustrate the activist's view to the stakeholders. Following Gantchev's (2013) view, these first two steps will be further grouped under one common stage being "demand negotiations". Following the public communication campaign, tactics continue to escalate to put more pressure on the company. Indeed, shareholder activists usually continue their road to influence by sending shareholder proposals or a publicly filed letter, and in the meantime, require board representation. If they do not obtain a board seat, they will likely threaten the target with a proxy fight or ultimately engage in such a fight. Finally, activists can also initiate lawsuits targeted against takeover defences such as poison pills or staggered boards. In some extreme cases, the activist could even consider a hostile takeover bid to force his view on the management; however, this is rarely the initial purpose of an activist. In the following section, the different tactics used by shareholder activists are discussed, with a main focus on proxy fights.

2.1 Demand negotiations

The very first step for shareholder activists is to assess different criteria, discussed earlier, to determine an appealing target where the activist could make a difference. Thereafter they will establish a business improvement plan that includes the changes they want to bring to the targeted firm. This plan is often completed while interacting privately with the management to have a better view on the current situation and the potential improvement (Levin, 2010). The extent to which the management opens up to the activist's plan is highly case dependent and is strongly influenced by the relationship between the two parties, the activists' reputation and his credibility. Private interactions are often also directed towards board members or other shareholders. Indeed, testing the waters is crucial to understand whether stakeholders will be supportive or not. Recently, these traditional shareholders are more frequently involved in these private discussions, whether it is to support or oppose the activists (J.P. Morgan, 2019). The communication between the different parties can be done through several means such as conversations with some or all the stakeholders, through letters send by the activist to the stakeholders, or the activist can go close to the limit with public negotiations and seek on-record conversations (Wachtell, Lipton, Rosen & Katz, 2016).

Occasionally, these private negotiations are enough to drive significant changes to a company, as large as it may be. In 2013, ValueAct Capital Management, an activist investment company led by Jeffrey Ubben, bought a 0.8% stake in Microsoft (Vardi, 2013). Despite this very low stake, the activist managed to obtain a board seat at the target and is more than likely behind

the resignation of Microsoft's CEO Steve Ballmer. Moreover, as the activist's stake did not reach the threshold of 5%, it did not need to submit a Schedule 13D or to inform the public. Hence, the overall majority of the campaign was handled privately between the stakeholders and the fund (Foley, 2014).

Of course, since private negotiations with the company are the methods putting the least amount of pressure on the target, they have low success rates and regularly require further public negotiations, which are often more coercive (Wachtell, Lipton, Rosen & Katz, 2016). As discussed earlier, a first tool used by shareholder activist to publicly announce their interest in a company is the filing of a Schedule 13D. These filings are to be submitted to the U.S. SEC, which publicly discloses this information (U.S. Securities and Exchange Commission, n.d.). Wachtell, Litpon, Rosen & Katz (2016) presents several other public approaches used by shareholder activists such as shareholder proposals, proxy fights, and lawsuits. However, activists do not always need to resort to these more aggressive public tactics, hence, they will be discussed in the coming sections as next steps. Most common public tactics are publicity campaigns where the activist discloses letters and presentations of the company and he sometimes issues press releases (Sullivan & Cromwell, 2019). These different public tactics, which are less aggressive than proxy contests, are increasingly supported by the use of social media communication (Wolosky, Freedman, & Berenblat, 2018). During the last decade, platforms such as Facebook and Twitter have strongly influenced our society by providing new and more efficient communication means (Kaplan & Haenlein, 2010). Moreover, social media has been proven to have an impact on business metrics such as firm value and performance (Luo, Zhang, & Duan, 2013). Activists often use social media as a tool to put pressure on the different stakeholders of the target company. During Icahn Enterprises' campaign against Apple from 2013 to 2015, several tweets of Carl Icahn, the CEO of Icahn Enterprises and activist having the largest reach on Twitter, generated significative abnormal returns, with one tweet going up to 10.22 percent cumulative abnormal return (Dinh, Kopf, & Seitz, 2017).

Social media can further be used to communicate with shareholders and try to obtain proxy votes (Wolosky, Freedman, & Berenblat, 2018; McRitchie, 2019). Wolosky et al. (2018) argue that communication on Facebook and Twitter is essential to keep the activist's target audience up to date in real time on the campaign evolution or to share links to their own platforms. Moreover, in the period close to a proxy contest, activists can use targeted advertising to make sure that the firm's stakeholders are informed. The paid ads data along with proper data analytics enable the activist to better understand which opinion is more popular to optimise their propositions. Next to shareholder activists, other institutional investors also influence

retail shareholders and other institutional funds by announcing how they will vote in the coming proxy fight (McRitchie, 2019).

Third Point Management, a New York-based activist hedge fund, made strong use of social media in its campaign against Campbell Soup, in which it holds a 7% stake. The activist created a video targeted at retail investors to illustrate the firm's underperformance by comparing it to S&P500 index and CPG competitors. Moreover, the video also includes a phone call with interim CEO Keith McLoughlin who points out the poor execution of the company (Levine, 2018). Later on, Third Point lost a lawsuit against Campbell Soup where the activist claimed the firm misled its shareholders regarding the competencies of its board of directors (Fortado, 2018). Finally, the two parties reached an agreement where the activist could replace and choose two board seats (Fortado, 2018). Social media certainly played an important role in these negotiations, but it was combined with other activists' tactics.

Private and public discussions with the target are time intensive and show relatively high costs, even though they have a low success rate (Gantchev, 2013). If these first negotiations fail, the activist has two major choices, either he starts the next stage by requiring board seats and emitting shareholder proposals or, the shareholder assesses that the campaign would be too expensive and is not likely to lead to the expected results, hence, he decides to exit his investment (PwC, 2015). In the next paragraph, the former scenario is discussed.

2.2 Board representation and settlement agreement

In his paper, Gantchev (2013) defines the second stage of the activist's campaign as the request for board representation, which is often supported by a shareholder proposal. Appointing new members to the board of directors is important for activists as they can have a significant impact on the company (Boland & Hofstrand, 2009). Indeed, the board can appoint the firm's CEO and it helps in determining the company's overall direction or strategy. Hence, gaining board seats is an interesting way for the activist to implement its strategy and vision at the targeted firm. A complementary tool to further inform shareholders about the activist's objectives is the shareholder proposal. The U.S. Securities & Exchange Commission states that shareholders having more than a 1 percent stake in the company or $2,000 in shares for more than a year can submit a proposal under SEC rule 14a-8. This proposal can be supported by a 500-word essay and must be reviewed by the SEC. If accepted, the company is required to include this proposal to the agenda of the next shareholders' meeting and to hold a vote upon it (Denes, Karpoff, & McWilliams, 2017; McGuire, 2017). Shareholder proposals are non-binding, however, their impact should not be neglected; many recent corporate practices, often linked to ESG, have been initiated by proposals (Lewis, 2018).

Another low-cost technique used by shareholder activists is the “vote no” campaigns (Del Guercio, Seery, & Woidtke, 2008). These campaigns are targeted towards other shareholders with the aim to convince them to withhold their vote from director candidates or to vote against the proposed company’s remuneration policy (PwC, 2018). The results of these votes are in the overall majority of cases in favour of the company; in 2018 up to 97.9 percent of the companies holding say on pay votes ended up with a majority of shareholders approval (Semler Brossy, 2018), similar results can be found for withhold campaigns (PwC, 2018). Yet, say on pay and withhold votes can have an important impact. According to Semler Brossy (2018) and PwC’s (2018) reports, the outcomes are usually in favour of the company’s proposition with more than 90% of the votes. Hence, campaigns showing a substantial number of withheld votes can impact the directors’ reputation and push them to act voluntarily (Grundfest, 1992). However, activists sometimes argue that boards will only act if legally binding action is initiated, making shareholder proposals, vote no and withhold campaigns ineffective (Del Guercio, Seery, & Woidtke, 2008). Yet, Del Guercio et al. (2008) find supporting evidence, such as higher CEO turnover, that these campaigns push boards to take action in the interest of shareholders, making these effective tools for activist investors.

Costs linked to shareholder proposals, withhold or vote-no campaigns are low when compared to the capital invested by hedge fund activists (Denes, Karpoff, & McWilliams, 2017; Del Guercio, Seery, & Woidtke, 2008). These lower costs, coupled with the lower amount of time invested, make these solutions preferable for shareholder activists’ campaigns. Indeed, if the activist does not reach his objective, he can either exit his investment or launch a proxy contest (PwC, 2015). At this stage, the negotiations between the management and the activist become more hostile (Wachtell, Lipton, Rosen & Katz, 2016). Moreover, proxy fights can often become very expensive if no settlement agreement is found (Gantchev, 2013).

In order to avoid these expensive proxy fights, companies increasingly tend to co-operate with activists and find early settlement agreements (Flasherty & Athavaley, 2015). In 2013, 30 percent of the board seats were won through proxy fights but this number decreased to 22 percent in 2018 for companies with a market cap greater than $500 million (Lazard, 2018). Moreover, the average time from disclosure to settlement agreement decreased from 83 days in 2010 to 56 days in 2015 (Flasherty & Athavaley, 2015). Commentators link this decrease to companies wanting to avoid the high costs, damaging publicity, and the high-time investment necessary to manage the proxy contest. Others argue that the increase in the number of settlements and settlement pace is due to boards and shareholders recognising that activists bring significant value to the target (Bork, 2016). A last possibility supported by Bork (2016) is that companies are quickly conceding board seats as a defensive measure. Bowing too quickly

to activists can be harmful for the company's long-term shareholders' interest. Making hasty decisions without consulting the shareholders could lead to short-term prioritisation, sometimes at the expense of long-term performance. These defensive measures could be a direct consequence of the higher support provided to shareholder activists by institutional investors during votes (Flasherty & Athavaley, 2015).

These trends regarding settlement agreements are applicable to the global markets but show strong differences between the mature U.S. market and the rest of the world. According to activist insight (2019), among all the board seats obtained by activists in the U.S., 88 percent were won via settlement agreement. Canada remains close to the U.S. whereas it also has a majority of board seats won through settlement. However, Europe, Asia, and Australia are far behind the U.S. and Canada with an average of only 31 percent of board seats won without proxy fight (Activist Insight, 2019). This spectacular difference could be explained by market maturity regarding shareholder activists. Non-U.S. activism grew from 24 percent in 2011 of global activism to 52 percent in 2017 (J.P. Morgan, 2018), hence, non-U.S. markets and shareholders still need to get familiar with activism. The U.S., having a long history with activists, has more institutional shareholders supporting these activists and companies are more likely to lose proxy contests, hence, increasingly try to avoid them.

When shareholder activists and a target firm agree on a settlement, the activist typically receives the right to appoint between one and three directors at the board (Noreuil, 2016). However, shareholder activists need to continuously pay attention as companies sometimes agree to add or replace board members as a defensive strategy. The target will likely add constraints to limit the influence of the activist (Rosewater & Tomasetti, 2009). A first defence strategy is the timing of director appointment, the target may try to delay the appointment until the next shareholder meeting preventing the activist to immediately implement his initiatives. Another constraint negotiated between activists and companies is the amount of influence the new nominee will have. Companies can protect some decisions from certain board members by providing different decision-making power to different directors (Aquila, 2015). Furthermore, replacement and removal of the investor's newly appointed director is a crucial issue during negotiations. For instance, in order to avoid that board members would represent small shareholders, companies can negotiate that if the stake of the activist decreases under a certain threshold, the appointed director would be removed (Aquila, 2015). Board members' replacement in case the newly appointed director steps down or cannot continue service is another important matter that requires extra specification in the settlement agreement (Rosewater & Tomasetti, 2009).

Negotiations towards settlement agreements generally cover more issues than the composition or representation at the board of directors. During the standstill provisions of a settlement agreement, the company usually imposes restrictions on the activist (Aquila, 2015). Investors are usually confronted to two types of standstill provisions usually lasting for one year: ownership standstill and corporate governance standstill (Rosewater & Tomasetti, 2009; Liekefett & Elbaum, 2016). The first type covers elements such as imposing limits on the acquisition, transfer or sale of the target's securities, while the second type focuses on restricting investor activities and voting agreements. The restriction on the trading of shares obliges the activist to notify the company before transferring, selling or purchasing more than a certain number of shares. This is a crucial measure to limit the risk of additional pressure from another activist investor. Furthermore, during this standstill, the investor cannot perform certain activities such as seeking more board seats, submitting or encouraging shareholders to submit proposals, participating in proxies opposing the board, trying to control the management or the board of the target, or proposing special transactions involving the company such as M&As (Aquila, 2015; Noreuil, 2016). Next to the usual standstill provisions, Aquila (2015) mentions other topics the contract can include, such as specifying which initiatives the activist can or cannot undertake, the potential reimbursement of expenses incurred during the campaign, and how both parties will communicate about the settlement agreement. Aquila (2015) finds that in many cases, the target agrees to reimburse the activist for most of the legal fees linked to his campaign.

Most of the settlements occur before the proxy contest, however, if settlement occurs after the initiation of a proxy contest, the costs of the campaign can be very high. Gantchev (2013) finds that the cost of a campaign ending in a proxy contests is more than $10 million, with the proxy stage representing more than 50% of these costs.

2.3 Proxy fights

In general, shareholder activists prefer to find an agreement as soon as possible without requiring any proxy fight (Gow, Shin, & Srinivasan, 2014). Moreover, during the first phase of public negotiations as well as when activists ask for board representation, activists often threaten the company with proxy fights (PwC, 2015). The proxy threat is in most cases enough to convince the target to settle in order to avoid the proxy fight.

Yet, over the last three years, almost 20 percent of U.S. activist campaigns escalated to a proxy fight (Sawyer, Boehmke, & Ludewig, 2018). Moreover, given the often strong differences in opinion between shareholder activists and targets, settlements do not always result in eternal peace; sometimes, when the standstill period is over, the campaign restarts along with

new public negotiations and a proxy fight (Liekefett & Elbaum, 2016). Liekefett & Elbaum (2016) argue that once the activist had a board seat at the company, the director can share confidential information with the activist as long as the activist does not trade on the information. Hence, the target is in a perilous position to fight a proxy contest with the odds being in favour of the activist.

Proxy fights are contests for the control of the shareholder votes of a company. The vote is usually held to resolve a conflict between the board of directors and the activist (Fos, 2010). Shareholders have the right to vote at a shareholder meeting, however, public companies often have a large number of shareholders making it impossible to all meet in the same physical space. Hence, shareholders often vote by proxy: they provide someone else with a written authorisation to vote on their behalf (U.S. Securities and Exchange Commssion, n.d.). Moreover, individuals as well as institutional investors, sometimes hold multiple securities and are not always aware of how they should vote at every shareholder meeting. Understanding company-specific issues to make an informed vote can be time and resource intensive for shareholders. Even small and mid-sized funds do not always have the necessary resources to gather enough information about all the companies in their portfolio (Larcker, Tayan, & Copland, 2018). Hence, proxy advisors play an important role by pooling the voting rights of the different shareholders and make an informed vote on their behalf. Moreover, since 2003, as a means to enable more transparency in the voting process, institutional investors are required by the SEC to disclose their voting policies or the voting policies of the third-part agent (Larcker, Tayan, & Copland, 2018). Hence, shareholders can avoid losing a significant amount of cost and time by using proxy advisors.

By pooling these votes, the largest proxy advisors, such as Institutional Shareholder Service and Glass Lewis & Co., have acquired tremendous power and influence in the voting outcomes of proxy contests (Brannon & Whitley, 2018). These instances have respectively 60 percent and 35 percent market share (Stimmell & Schnell, 2017). The literature does not show any consensus regarding the voting power of these advisors, however, the influence is real; ISS is said to influence on average 6-10%, 13.6-20.6%, or even 25% of the votes (Choi, Fisch, & Kahan, 2009; Bethel & Gillan, 2002; Brannon & Whitley, 2018). Hence, proxy advisors have a strong influence on defining industry best practices regarding issues such as corporate governance.

Proxy advisors often provide guidance regarding corporate governance for companies and investors. Activists can use these guidelines to better forecast whether they are likely to receive support or not from the advisors. ISS considers that board member tenure for more than 9 years as excessive. The advisor will always advise voting against the creation of

staggered board. ISS releases more details about its position such as guidelines for CEO succession planning, board size, takeover defences, etc. (Park, 2016).

The case between Starboard Value and Bristol-Myers Squibb is a recent illustration of the strong influence of these proxy advisors. In February 2019, the activist hedge fund Starboard Value tried to leverage its stake in Bristol-Myers Squibb to oppose the planned acquisition of Celgene for $74 billion arguing that "the proposed acquisition of Celgene Corporation was poorly conceived and ill-advised" (Franck, Activist investor Starboard Value says it will oppose Bristol-Myers' $74 billion deal for Celgene, 2019). Yet, two months later, the major proxy advisors ISS and GL advised voting against the transaction. Even though the other stakeholders increasingly opposed the acquisition plan, Starboard Value decided to abandon its campaign (Franck, 2019).

As mentioned earlier, Gantchev (2013) finds that the total cost of an activist campaign resulting in a proxy contest amounts to $10 million. In 2017, Trian Fund purchased a 1.4 percent stake in Procter & Gamble, the largest firm ever targeted by activists with a market capitalisation of $223 billion. Nelson Peltz's campaign for a board seat escalated to the most expensive proxy fight in history, estimated at $60 million (Coronato, 2017). Mid-November 2017, the activist lost his proxy contest against P&G, however, a month later he still secured a board seat. According to a competitor, in order to avoid these extremely high proxy costs, the activist should have asked for more than what he actually needed, in order to directly obtain his board seat. This negotiation tactic is increasingly used by activists and could lead to more and quicker settlement agreements (Fortado, 2019).

2.4 Lawsuit and hostile takeovers

When shareholders' non-binding negotiation tools such as proposals, say-on-pay resolutions, and requests to elect new board seats are ignored by the company, activists can launch proxy contests, or less frequently, shareholder activists can go as far as threatening their target with litigation. In approximately 2 to 4 percent of the campaigns, activists initiate litigation (Sawyer, Boehmke, & Ludewig, 2018). Lawsuits initiated by activists can be related to a target refusing to share its books and records with the activists, to a target keeping its excess cash instead of returning it to its shareholders, or to the controlling shareholder engaging in transactions that could destroy value of the minority shareholders (Deveau, 2018; Carmody, 2013; Lahiri, 2018). Lawsuits are very aggressive but also effective means to bring change to a target; litigation often leads to immediate implementation of the required governance changes (Robbins & Razzouk, 2015). Moreover, Robbins & Razzouk (2015) argue that whereas proxy fights can be extremely expensive, litigation is a relatively cheap way of forcing change upon

a target. This aggressive tactic is often the consequence of management or board of directors ignoring and resisting the voice of shareholders. Shareholders should not accept all the shareholder proposals, however, many lawsuits could have been avoided if the management had been more open to communication and negotiation with shareholders (Robbins & Razzouk, 2015). On the other hand, Sawyer, Boehmke & Ludewig (2018) argue that litigation might be used as a tactic to publicly promote their vision and strategies or to put additional pressure on the management during an activist campaign. Yet another opinion from Liu, Varma & Veeraraghavan (2016) is that lawsuits can sometimes be meant to obtain information about the target or redeem poison pills. Hence, companies should remain vigilant in all circumstances and try to understand the reason behind the activist's legal attack.

In recent history, hedge fund activists resorted to hostile takeovers, a tactic usually reserved to other types of investors (Liu, Varma, & Veeraraghavan, 2016). After one year of pressuring the U.S. IT company Riverbed, the activist hedge fund Elliott Management decided to make an unexpected takeover bid. In the end, the activist was beaten by private equity fund Thoma Bravo, however, this surprising move was the first of its kind for the fund (Fortado & Massoudi, 2019). Later on, Elliott pursued his buying urge by acquiring Gigamon, Athenahealth, and Travelport. The latter two deals have been concluded by partnering with other investment funds (Chung & Lombardo, 2019). Other hedge fund activists have been launching similar attacks to difficult targets; for instance, the activist Pershing Square along with Valeant made a takeover bid on the Botox maker Allergan Pharmaceuticals or Carl Icahn who threatened Netflix with a hostile takeover (Levine, 2014; Musil, 2012).

Most activists usually lack the scale to engage in takeover bids, however, having the ability to deploy both activist and private equity strategies can increase the likeliness of achieving desired outcomes (Fortado & Massoudi, 2019).

3. Reacting to activist shareholder's threat

Activists are large, continue to grow, and win popularity every year. Hence, companies become increasingly likely to fall prey to these hedge funds and their aggressive methods (Foldsey, et al., 2015). A survey conducted in the U.S. found that almost 75 percent of public company CFOs say that shareholder activists have been in contact with management or the board, or made proposals directly aimed at the target's shareholders (Ruggeri, 2015). Hinkel et al. (2015) writes that "the single best way to ruin a CEO's day is to report that an activist is on the phone and has just taken a position in the CEO's company". Hence, the next section focuses on how shareholder activists impact the target and how firms can best prepare.

PwC (2015) defines three major ways, a targeted firm can be affected by activists. The first impact is that managers are distracted from their core activities to monitor and react to the activist. Public campaigns can drain a lot of time and energy from managers that need to defend and justify themselves. Hence, when the activist's major claim is that the target firm is underperforming, this distraction often results in a self-fulfilling prophecy. The second impact is the cost incurred during a proxy contest. Management and board members will require support from advisory firms with fees ranging from $10 million to $20 million. Finally, the firm's operations, the relationship with suppliers and customers, and employee morale can suffer from the increased uncertainty due to the activist's threat. Proxy contests usually take a total of 3.5 to 8 months between announcement and shareholder meeting (Johnson, Lamm, Pankopf, & Hassan, 2014; Herrington, 2017; PwC, 2015). Hence, in order to avoid activists or significantly reduce the different costs and time investment associated to an activist campaign, companies should make adequate preparations.

The best way to prepare for activists is to think and analyse your company like an activist would do (Foldsey, et al., 2015). Hence, identifying issues the activists might want to address is important. For instance, if your firm underperforms compared to peers in the industry activist might come and strike. Several firms use activist role-plays to proactively audit their performance and review their strategy accordingly to avoid activists (Cyriac, Otto, & Wells, 2017). Next to the crucial issue regarding a company's underperformance, other aspects that could encourage activists to launch a campaign against a firm should be regularly reviewed by taking an activist standpoint. These aspects were discussed under the section "Target Selection" of this paper and include topics such as M&A moves, corporate governance, capital allocation, capital structure, etc.

When the risk of an activist launching a campaign increases, preparing a plan in advance is important (Hinkel, Poppe, Toner, & Whitten, 2015). During a proxy contest, the activist will try

to convince shareholders to agree with his vision. Hence, creating solid relations with current investors is critical. Hinkel et al. (2015) argue that investor relationship management comes with five critical steps. Firstly, the firm should perform a realistic internal valuation with objective forecasts. Next, the company should compare this internal value with the current market value and try to understand where the gap comes from. Steps 3 and 4 stipulate that the management should focus its attention on the most critical investors who are receptive to the company's current strategy and align with them. Finally, the business should align its objectives with the investors' objectives. A strong investor relationship management eliminates arbitrage by aligning the market value with the firm's intrinsic value and increases shareholder support. Ruggeri (2015) emphasises that proactively engaging with current investors is a powerful tool that can increase the management's credibility in the eyes of investors. Hence, these shareholders will more likely defend the management if an activist comes knocking at the door.

Creating a proper response team and protocol in case an activist contacts the management is also part of the important preparation steps (Ruggeri, 2015). The team should include financial advisors, accountants, managers with experience in investor relationship, and public relations. In case an activist launches a campaign against the company, the response team should be prepared to research and evaluate the activist's thesis and develop the adequate response plan (Hinkel, Poppe, Toner, & Whitten, 2015). Next to a response team, it is important to be attentive to warning signs such as changes in the shareholder base or analyst reports suggesting changes to the firm (Wachtell, Lipton, Rosen & Katz, 2016). Finally, the management should be ready to react to the first phone call or letter sent by activists.

If an activist makes his move, the first reaction is important as it will impact how hostile or collaborative the activist's campaign will be (Cyriac, Otto, & Wells, 2017). In the past, companies used to ignore activist with a ~5 percent stake in the company thinking it could not exert any influence. The management often implemented defensive measures to avoid an activist's recommendations or hostile takeover bid (Liu, Varma, & Veeraraghavan, 2016). Nowadays, in most cases, it is important to listen to the activist and avoid defensive approaches; activists could have surprisingly good ideas for the company (PwC, 2018). Hence, management should take time to listen and consider the activist's proposals. The response team should make sure to understand what the activist wants and adapt its communication with that in mind (Hinkel, Poppe, Toner, & Whitten, 2015). Wachtell, Lipton, Rosen & Katz (2016) advices the targeted firm to leave important conversations with the activist to the CEO, it is crucial to communicate with one voice to avoid misinformation.

When possible, trying to keep the campaign private can help to avoid media distraction. Indeed, managing the activist is important but the company should not forget to run the business in order to avoid additional underperformance (Wachtell, Lipton, Rosen & Katz, 2016). It can be tempting to share a very positive story with other shareholders; however, the activist might already be contacting them. Hence, complete transparency towards investors is required to make them trust the management (Foldsey, et al., 2015).

Foldsey et al. (2015) state that activists often start a campaign with a clear end goal in mind and are ready to deploy the necessary means to achieve it, even if it requires a proxy contest or lawsuit. The negotiations can be intense and require much time investment, however, if the firm is correctly prepared to an activist's campaign, both parties can find a quick and positive settlement agreement. In the end, shareholder activists try to create value, hence, if preparations are well-made, all stakeholders can benefit.

Part 2: Impact and Strategies of Shareholder Activists

Introduction

Can activist hedge fund generate significant value for the firm, and if so, which strategies are the most successful? Following sections try to answer these questions by reviewing the literature and expert reports regarding the impact of activists on the targeted firms. This section starts by focusing on the excess returns generated by activist campaigns. As researchers find different results depending on the period of the dataset and on the activist's investment horizon, the first part makes a clear distinction between pre-crisis and post-crisis papers as well as short-term and long-term overperformance.

Depending on the strategy used by activists, the generated returns can vary (Hinkel, Poppe, Toner, & Whitten, 2015). Hence, the next section focuses on 4 major strategies being changing the capital structure, improving the target's governance at a corporate, management, or board level, reshaping the business strategy or operations, and opposing or promoting an M&A transaction. Moreover, understanding the different strategies put in place by activists can help companies to avoid activists by implementing these strategies on their own.

This part concludes with the impact of environmental, social, and governmental issues on today's hedge fund activism landscape as well as whether addressing these issues can have a positive impact on a target's performance. ESG concerns become central to many investors worldwide, hence, activists have to adapt their strategy to include this trend in their investment policy.

1. Impact and returns generated by Shareholder Activists

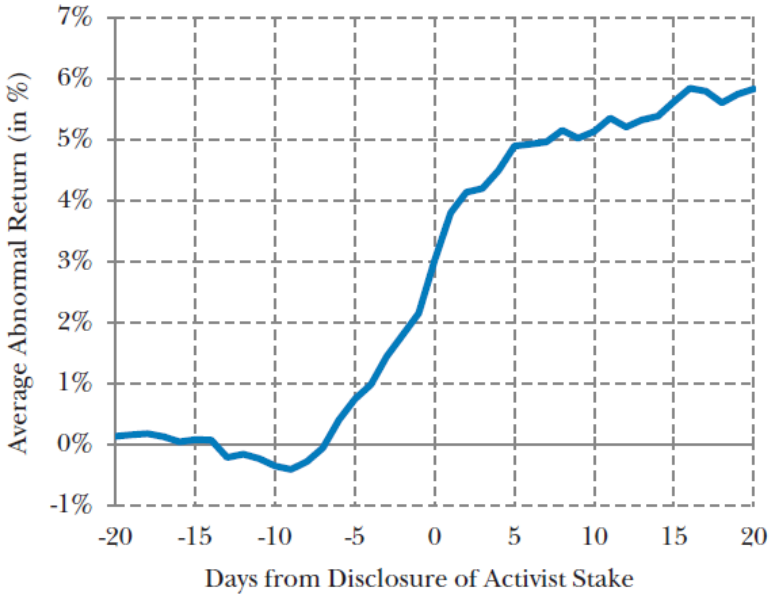
Hegde fund activists frequently use aggressive tactics against their target firm to force their vision and strategy (Lipton, Rosenblum, Cain, & Niles, 2019). During an activist campaign, the management also risks losing his focus from the firm's different business divisions to spend time managing and defending against the activist (PwC, 2015). Moreover, the cost of an activist campaign, on average $10 million for a full-fledged campaign, is not negligible (Gantchev, 2013). All these negative side effects from activism are tolerated by the increasing number of investors in activist hedge funds, who are attracted by the promised abnormal returns. However, the literature reports mixed results regarding the returns generated by shareholder activists.

Studies focusing on U.S. shareholder activism usually create a dataset of activist events based on Schedule 13D filings (Klein & Zur, 2009; Greenwood & Schor, 2009; Gantchev, 2013). This data is often complemented by manual searches through press releases to include activism events with stakes lower than five percent. Furthermore, researchers often add constraints on the type of activism agenda or on whether the campaign went to a proxy contest or not. Papers analysing non-U.S. activism events collect data from disclosures of a least 5 percent in targeted companies, by gathering press releases, or sometimes directly from hedge funds (Brav, Jiang, & Kim, 2010).

Several pre-crisis studies find evidence for both short-term and long-term overperformance when comparing companies targeted by activists with indexes or random company samples. For instance, Brav et al. (2008) studying hedge fund activism performance on a dataset of 1,059 activism events from 2001 to 2006, they find that upon announcement, activists generate abnormal returns of 7 percent. Moreover, this excess performance is maintained during the following year. Hedge funds activists can benefit from this increased performance, outperforming other types of hedge funds over the same period. Bebchuk, Brav, and Jiang (2015) support these findings by analysing 2,000 activist events from 1994 to 2007. They first assess the short-term performance looking at twenty days prior and after the filing of a Schedule 13D.

As shown in Figure 1, Bebchuk et al. (2015) find that short-term excess return rises to 6 percent in the first twenty days after announcement. Moreover, the targets start to overperform compared to benchmark indexes as soon as 7 days before the entry of the activist, probably due to the amount of stock acquired. The authors further analysed the long-term performance of the targeted firms over a period of 5 years. They observe a significant overperformance compared to benchmarks of 0.33 percent and 0.23 percent for holding periods of respectively 3 years and 5 years.

Figure 1: Short-term abnormal returns around disclosure date



Note: From "The Long-Term Effects of Hedge Fund Activism", by L. A., Bebchuk, A. Brav,, & W., Jiang (2015). Columbia Law Review, Vol. 115, 1085-1156.

Other multiple studies using similar methods find that, based on a pre-crisis dataset, shareholder activists generate positive short-term returns ranging from 3% up to 8% (Clifford, 2008; Klein & Zur, 2009; Greenwood & Schor, 2009; Brav, Jiang, & Kim, 2010). When analysing the long-term impact of hedge fund activism, most studies show positive returns, yet, researchers are not unanimous (Carrothers, 2017). Greenwood and Schor (2009) find that the majority of activism targets do not generate abnormal returns significantly different from zero. Only the targets that result in a merger or an acquisition generate positive excess returns. Hence, they argue that activist investors' ultimate goal is to see their underperforming targets bought out, preferably within their short investment horizon. On the other hand, Klein and Zur (2009) find that activists invest in healthy companies that do not underperform. Further, their sample shows an overperformance during the first month following the campaign announcement, however, the performance is only maintained over the long run and does not increase anymore. Finally, they observe that, a year after the activist purchased a stake in the company, accounting performances of the target do not improve. Instead, excess returns come from the increased debt capacity and the higher dividend payout.

Research using a post-crisis dataset regarding the shareholder activists' performance shows more balanced results. A 2014 McKinsey report performed on a dataset from 2001 to 2014

found that the excess total return to shareholders relative to industry average was positive for the three years after the announcement date (Cyriac, De Backer, & Sanders, 2014). The research even mentioned the positive effects of shareholder activism through improvements relating to the strategy or strengthening of the board of directors. However, in 2017, McKinsey released another report based on a dataset from 2007 to 2017, stating that activists' performance was mixed (Cyriac, Otto, & Wells, 2017). Whereas the first research mentioned positive excess returns of 5% for the next three years after the campaign, the second paper splits the dataset in two and presents the top-quartile companies and their highly significant excess return along with the bottom-quartile companies showing significant negative returns. In this analysis, top-quartile firms generated 1 year, 2 years, and 3 years after the campaign announcement, excess returns of respectively 16 percent, 17 percent, and 9 percent, while bottom-quartile firms generated excess returns of -12 percent, -10 percent, and -12 percent.

In 2015, The Economist presented a study performed on the 50 largest positions taken by shareholder activists from 2009 to 2014 (The Economist, 2015). The paper shows improvements in performance regarding market capitalisation, R&D, investment policy, net income, and a decrease in leverage. However, Allaire (2015) compares this sample from The Economist with a random sample of companies over the same period. His research shows that the improvements in market capitalisation, R&D, and net income are lower than in his random sample. The activist dataset only slightly overperformed regarding investments made and leverage, exposing the mixed results of shareholder activism. Moreover, recent literature from deHaan, Larcker, and McClure (2018) find that long-term positive and significant excess returns are driven by the smallest firms in their sample, with a market value averaging $22m. Larger firms, representing 80 percent of the activist cases, show insignificant negative long-term returns. When the entire sample's excess returns are value-weighted, the targeted firms perform in line with common benchmarks.

Another approach to analysing shareholder activism is by looking at the impact of the tools or tactics they use. Ferri (2012) studied how 'low-cost' tactics, such as shareholder proposals and shareholder votes for board members, impact the target's performance. Even though these easily accessible tools are non-binding for the target firm, his findings suggest that they can be powerful drivers for improvement and influence. Cuñat, Gine, and Guadalupe (2012) find that approved shareholder proposals generate immediate abnormal returns of 1.3 percent with a total market value going up to 2.8 percent.

Further proof of the growing importance and belief in shareholder activism, is the U.S. based 13D Activist Fund (13D Activist Fund, 2019). This mutual fund was created in 2006 and invests its assets in companies targeted by activist campaigns. The investment policy is driven by

multiple research presenting the excess returns generated by shareholder activists. This fund analyses 13D filings of activists targeting firms with a market cap above $1 billion and invests in the most promising targets. Furthermore, it is important to mention that 13D Activist Fund does not intend to generate short-term abnormal returns through the announcement effect, instead, it holds a long position in the targets for an average of 15 months. As of March 31, 2019, the fund manages $355 million and an investment in 29 firms. Over a period from December 28, 2011 until March 31, 2019, the fund generated a yearly return, net of fees, of 13.21 percent, beating the S&P 500 index, which generated a total yearly return of 10.36% over the same period. However, when looking at a shorter period, the fund did not succeed in beating the same index over the last 5 years, 3 years or last year. Indeed, this fund is not representative of the entire activist market as it only holds positions in 20 to 40 targets. In comparison, a report from Sullivan & Cromwell shows that the hedge fund activism industry returns for 2018 amounted to -4.4%, outperforming the S&P500 and Dow Jones Industrial Average, which had returns of -6.2% and -5.6% in 2018 (Sullivan & Cromwell, 2019). These results might indicate that the 13D Activist Fund did not make the best asset allocation choices.

The multiple recent studies discussed previously show that it is unclear whether hedge fund activists really generate high abnormal returns in the long-run. An additional weakness, suggesting even lower returns for shareholder activists is the high costs related to a campaign. Indeed, regardless of the conclusion, most of the literature only focuses on the company's performance, without analysing what the abnormal returns to the investors are, net of campaign costs and management fees (Gantchev, 2013; Norli, Ostergaard, & Schindele, 2014). The most common stages, through which almost all activist campaigns need to pass, are demand negotiations and board representation. Gantchev (2013) estimates the cost of each step to respectively $2.94 million and $1.83 million. The most expensive stage is the proxy contest, where costs average as high as $5.94 million, leading to an entire campaign costing around $10.71 million. Hence, according to Gantchev (2013) costs can represent up to two thirds of the gross returns generated by the activist. This leads to the next observation: passive shareholders of a targeted company can reap the benefits from the value creation process of activists (Norli, Ostergaard, & Schindele, 2014). Yet, Norli et al. (2014) suggests that shareholder activists can cover for their expenses through informed trading if the stocks are liquid enough. Hence, liquidity can be an important factor affecting activists' returns.

The impact of activism is often measured by analysing how the targeted firm performs compared to benchmarks; however, activists' impact has grown beyond the targeted companies. Gantchev, Gredil and Jotikashtira (2018) find that yet-to-be-targeted firms

proactively seek to improve business to minimise the activist threat. These companies are more likely to work with advisors, reduce their excess cash, review their pay-out policies, and improve their return on assets. These actions often lead to better performance and a lower probability of being targeted by activists.

Hence, in a period of increasing investments in index funds and ETFs with “lazy investors”, hedge fund activism creates a healthy pressure on management and board of directors (The Economist, 2015). Moreover, investors too are being forced to take part in the company’s governance and strategy, and hence, become more active.

2. Traditional strategies

Going more into details, several researchers point out that targeted firms generate different abnormal returns depending on the strategy announced by the activist. Brav, Jiang, and Kim (2010) find that selling the target firm as well as changing the business strategy are the categories leading to the highest abnormal returns. Moreover, they argue that these positive excess returns are generated in the short-run and maintained over the long-term, indicating that the market's initial reaction is correct. Bebchuk et al. (2015) identify 4 major strategies used by activists such as divesting assets, changing investment or payout policies, changing the capital structure, or even replacing the CEO. Other researchers use a similar but slightly different break down such as "general undervaluation, governance, selling target company, business strategy, and capital structure" (Carrothers, 2017) or even "corporate governance policies and voting procedures, business strategy, initiatives to sell off part of the firms, and other measures to improve efficiency" (Norli, Ostergaard, & Schindele, 2014). A report from Bain & Company further breaks it down in even more strategies being financial, business strategy, executive compensation, M&A outright, M&A portfolio re-evaluation, corporate governance, and no explicit thesis (Hinkel, Poppe, Toner, & Whitten, 2015). The latter is particularly interesting, they define investors without clear strategy as well as investors targeting the corporate governance as "agitators". Moreover, their results show that agitators perform poorly, generating little or no excess return, as compared to investors with a clear investment thesis.

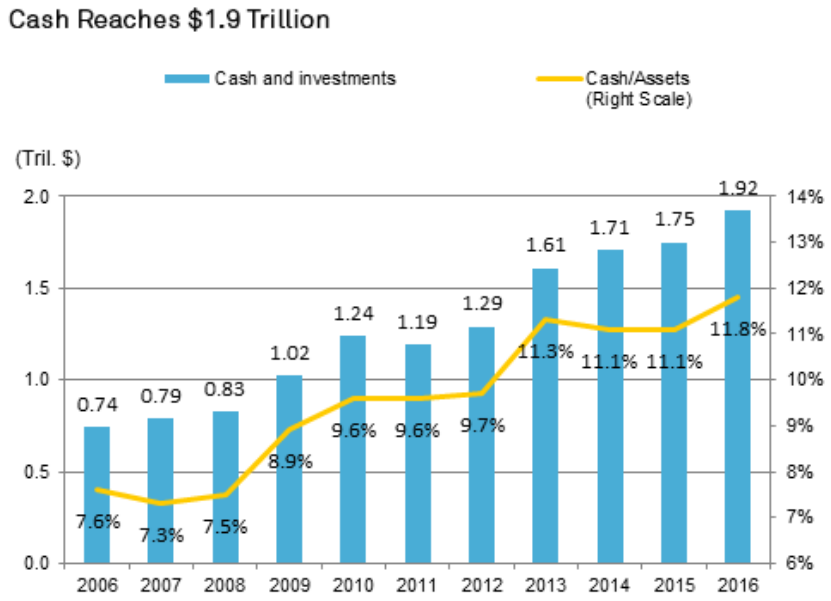
This analysis is based on Lazard's breakdown of shareholder activists' strategies. In their report, they identify 7 different strategies being capital structure changes, corporate governance improvement, business strategy, M&A, board change, management change, and operational improvement (Lazard, 2018). The following part introduces each strategy and provides recent examples where activist implemented these strategies. Furthermore, since board change, management change and corporate governance improvements often have the same strategical implications, they will be grouped under a same section, the same applies for business strategy and operations. Finally, it is worth noting that these strategies are not mutually exclusive, hence, activists often use multiple strategies against a single target (Carrothers, 2017; Hinkel, Poppe, Toner, & Whitten, 2015; Lazard, 2019)

2.1 Capital structure

Carrothers (2017) explains that when hedge fund activists target a firm for their capital structure, they usually focus on share buybacks, payout policies, excess cash, debt structure, recapitalisation, and leverage. Capital structure is an argument gaining popularity among

activists as U.S. firms hold record-high cash levels on their balance sheets. As illustrated in Figure 2, at the end of 2016, nonfinancial S&P500 firms held $1.9 trillion in cash and short- and long-term cash equivalents, representing a yearly increase of 10 percent since 2011 (Manzi, et al., 2017). Moreover, Figure 2 shows that the cash-to-asset ratio also increases, confirming that firms keep higher levels of cash in comparison to their total assets. A high cash ratio is an indicator for a healthy balance sheet, however, this sleeping cash generate additional returns if invested properly (Loop, 2016). Loop (2016) finds that companies are challenged by an activist campaign, increase their dividends and spending on share buybacks by an average of 22 percent. The low interest rates, enabling firms to borrow at low cost, have further contributed to this trend. On the other hand, Lipton (2013) criticises certain 'capital structure' activism practices, writing that activists increase leverage of the target firm to fund the payout or share buyback policies, solely focusing on the short-term at the expense of long-term performance.

Figure 2: Cash held by S&P500 firms



Note: From "U.S. Corporate Cash Reaches $1.9 Trillion But Rising Debt and Tax Reform Pose Risk", by J. Manzi (2017). Standard & Poor's Financial Services LLC.

These capital structure changes can be driven by the other improvements implemented by the activist or purely by reducing the excess cash or increasing the debt level. When the investment company and activist ValueAct Capital disclosed its $1.2 billion stake in the

investment bank and financial service provider Citigroup, an immediate claim was that the target could return $50 billion to its investors through increased dividends or share buybacks (Son & Picker, 2018). The activist has several stakes in companies from the financial sector such as KKR and Morgan Stanley, which he claims provided the fund with expertise to improve Citigroup's performance.

In 2017, before taking Ansalado STS, an Italian rail-signalling company, private, the Japanese majority shareholder Hitachi clashed with activists Elliot Management, Litespeed, and Amber owning a combined share of more than 30 percent (Segreti & Anzolin, 2017). The activists have been complaining about the price paid by Hitachi for the 51 percent stake he purchased, saying the bid price was too low and accusing the new majority shareholder and the seller of collusion. Moreover, the activists also attacked the dividend policy stating it was too low, leading to Hitachi scrapping the dividend. This fight continued until Hitachi offered a fair price to purchase all the remaining shares, taking the firm private with 99 percent ownership (Landini & Piovaccari, 2018).

2.2 Corporate governance, board, and management change

A well-documented concern regarding corporate governance in the literature is the agency conflict between a fragmented shareholder base and the management. A second conflict is the free-rider problem in which active shareholders will benefit the other shareholders with whom he competes (Lewellen & Lewellen, 2018). Goodwin (2015) argues that as shareholder activists create shareholder value by influencing and monitoring targeted firms, they can help in reducing agency costs.

Corporate governance changes by hedge fund activists usually focus on executive compensation, CEO, chairman or board members replacement, fraud, inspecting the books, or redeem takeover defences such as poison pills (Carrothers, 2017; Hinkel, Poppe, Toner, & Whitten, 2015). Governance changes can also be targeted at company policies such as changing the directors' election mechanism from a plurality voting system to a majority voting standard (Goodwin, 2015). Moreover, Goodwin (2015) points out that some activist events might not be financially driven but rather socially driven, hence, focusing on improving the company's social responsibility practices. This will further be discussed under section 3 about ESG.

Hinkel et al. (2015) find in their research that more than 75 percent of the activist demands involve replacing or nominating directors. Furthermore, J.P. Morgan (2019) state in their annual activist report that board representation itself is not a campaign goal. However,

according to the same report, it remains a frequent and successful strategy where 63 percent of the completed campaigns in the U.S. resulted in at least 1 board seat for the activist.

Activist fund Greenlight Capital has been a shareholder of General Motors since early 2015, however, their campaign as activists only started in 2017's first quarter (Vardy, 2017). A few weeks after the launch of their campaign, the fund disclosed a presentation to convince other shareholders to support their project (Greenlight, 2017). In this presentation, next to the proposition to create two classes of common stock, the activist attacks the current board of directors saying they lack involvement with GM as they only have small stakes. Hence, the fund tries to nominate 3 new board seats, which, in comparison with their 3.6 percent stake, seems more than reasonable.

Today we know that Greenlight's campaign failed. After proxy advisors ISS and GL recommended voting against the activist's proposal, Greenlight lost with 91 percent of the votes against him (Ferris, 2017).

A second case regarding corporate activism is when event-driven and activism fund CIAM launched a campaign against the Dutch-Belgian supermarket company, Ahold Delhaize. The campaign was aimed at redeeming the poison pill put in place by the target to counter potential hostile acquirers (Keidan & Deutsch, 2018). The activist claims that this poison pill causes Ahold to be undervalued. Less than two weeks later, Ahold appeased the investor's pressure by giving them more rights; the poison pill would remain effective, however, in case of a takeover, shareholders will be the ones to decide to pull the trigger or not. This concession was enough for CIAM to stop its campaign, claiming "this marks a significant victory for corporate governance and investor rights" (Meijer, 2018).

2.3 Business Strategy and operations

When activists target a company claiming they will change or improve the firm's business strategy or operations, they usually engage with management to adjust the company's goals and establish a clear plan to reach these goals (Hinkel, Poppe, Toner, & Whitten, 2015). These techniques usually include changes in cost structures, a revision of the business plan, and refocusing the company on core business units, often by spinning-off noncore assets (Brav, Jiang, Partnoy, & Randall, 2008). Along with M&A strategies, Brav et al. (2008) find that changes in business strategy are associated with the highest abnormal returns.

Management teams usually do not wish to sell noncore businesses as they would be at the head a smaller company (Allen, 2017). However, Allen (2017) points out that divestments can lead to significant improvements by reducing the complexity and refocusing on the company's

core segments. Over a 10-year period, companies engaging in BU sales outperform their inactive peers by about 15 percent based on total shareholder returns. The management should regularly assess the fit of the different divisions, try to estimate the synergies and dis-synergies to identify BUs that could deliver more value when sold (Wininger & Rujana, 2017).

Despite clear guidelines from advisory firms regarding divestitures, Chen and Feldman (2018) find that these agency costs between the management and the shareholders are real, hence, solving these could create significant improvements for the valuation of the company. Moreover, according to Chen and Feldman (2018), management-initiated divestitures significantly create less value than activist-initiated ones. The authors explain this is likely due to the high cost constraints linked to shareholder activists' campaigns, leading to a selection of the divestitures with the highest potential for value creation.

A potential hindrance to divest certain parts of the business is linked to the high income tax that comes with it (Ezekoye, Thomsen, & West, 2018). However, according to Erekoy et al., the U.S. tax reform, decreasing corporate federal income tax from 35 percent to 21 percent, will positively impact companies to pursue divestments. The authors argue that these lower taxes will result in greater returns for selling companies, which will in turn generate additional returns for shareholders. Hence, future activism campaigns will likely increasingly pressure management to divest, in order to capture these interesting shareholder returns.

Activism is often criticised for solely focusing on the short-term performance of targeted companies to generate quick shareholder gains. However, activism that directly addresses the long-term strategy or operations of a company helps to shift that perception (Loop, Bromilow, & Malone, 2018). Moreover, this strategy is frequently used by activists; Carrothers (2017) finds that more than one in five activist campaigns focus on business strategy.

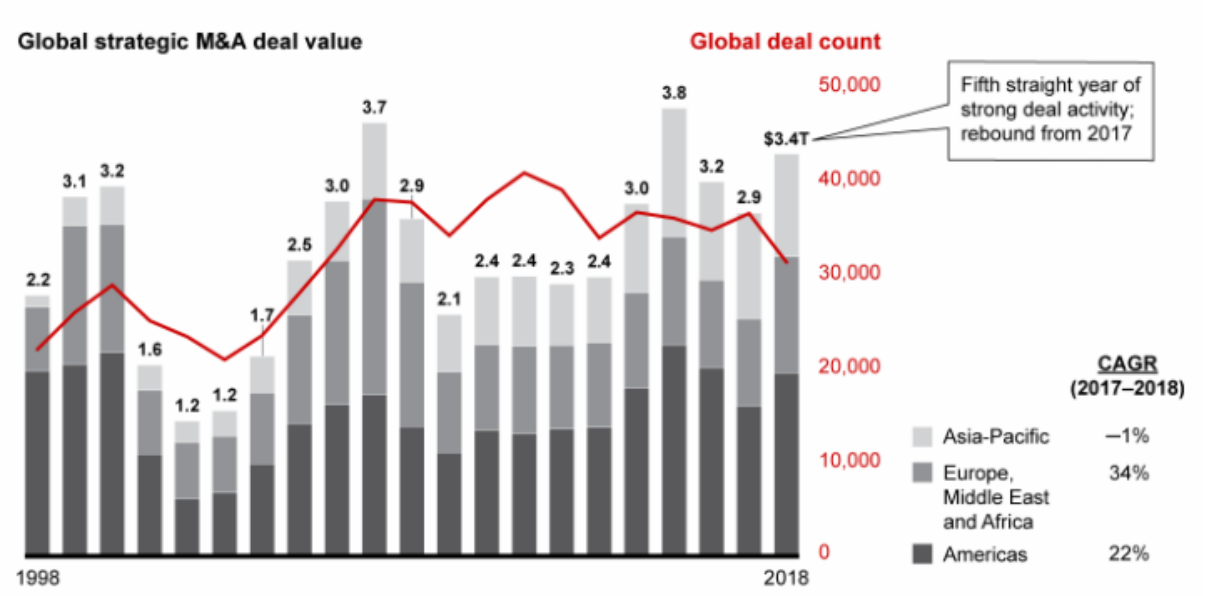
On August 4, 2017, the activist hedge fund Pershing Square Capital Management L.P. announced it had acquired an 8 percent stake in ADP, a company providing HR management software and services (McGil, 2017). Pershing Square announced that the campaign will focus on improving operating performance by enhancing the company's software and service offering, reducing the operating cost, and increasing efficiency. The activist held strong claims such as stating that the stock price could more than double in the next 5 years should the company follow the investor's claims and improve its margins (Herbst-Bayliss & Flaherty, 2017). To implement these changes, the activist initially wanted to collaborate with the management, however, due to increased tensions, the campaign ended up in a proxy contest. Pershing Square lost this proxy contest, however, a year later, the company's share price had

increased by 35 percent. This good performance led the activist to sell the majority of its ADP shares to focus on other investments (Herbst-Bayliss, 2018).

2.4 M&A

Baird et al. (2019) define 2018 as the year of disruption, with M&A being a common strategy in responding to these disruptive times and growth challenges face by companies. Figure 3: Global M&A activity based on deal value shows how these last five years, M&A activity has grown to be as high as pre-crisis levels. Moreover, recent growth mainly comes from the U.S., Europe, and Middle East, creating interesting opportunities for activists. According to Lazard (2019), 33 percent of all the activist campaigns of 2018 targeted at firms with a market capitalisation exceeding $500 million were M&A-related. 41 percent of these campaigns relate to the sales or consolidation of the target, 30 percent to improve or block existing acquisition plans, and 28 percent to break up the company.

Figure 3: Global M&A activity based on deal value



Note: From "Using M&A to Ride the Tide of Disruption" by Baird, Harding, Horsley, & Dhar (2019). Bain & Company.

M&A activity is crucial for activism, as, among all the strategies put in place by activists, it is the most profitable (Brav, Jiang, Partnoy, & Randall, 2008; Baird, Harding, Horsley, & Dhar, 2019). Greenwood and Schor's (2009) research goes even further, they find that the only

activist campaigns generating significant abnormal returns in the long-term are campaigns ending in the sale of the targeted firm.

A recent example started in October 2017 when the activist Blackwells Capital announced it purchased a 3.6 percent stake in the Irish company Supervalu. The initial claims were that the target was underperforming and lacked a clear strategy (Blackwells Capital, 2017). Several months later, Blackwells strongly criticised the target claiming they were destroying value and purposely ignoring interest of potential acquirers (Deveau, 2018). However, a year later, the distributor of organic food United Natural Foods, proceeded to the acquisition of Supervalu for $32.5 per share, a 111 percent increase compared to Blackwell's purchase price of $15.43 per share (United Natural Foods, 2018).

Apart from selling its target, activists also intervene to stop announced acquisitions or mergers. In August 2018, activist Carl Icahn initiated a campaign to oppose a deal between two healthcare companies Cigna Corporation and Express Scripts Holding, in which Cigna planned to acquire Express Scripts for $54 billion (Bloomberg, 2018). The activist sought a proxy fight to block the deal, however, ISS and GL advised voting against the Icahn's plan. Hence, the activist had to retreat, and in December 2018, Cigna proceeded with the acquisition of Express Scripts.

Activists' campaigns can sometimes be turned down, as illustrated in the case above, however, most of the time activists do reach their goals. Later in 2018, Icahn opposed another deal where Dell Technologies tried to acquire the software company VMware. Icahn strongly criticised Dell's $109 per share offer, claiming VMware should be worth as much as $300 per share (O'Donnell & Sharma, 2018). The activist-initiated proxy contest and lawsuit against the potential acquirer bore fruits; Dell increased its offer from $109 to $120 per share. This 10 percent increase was sufficient for Carl Icahn to halt his campaign, claiming that the activist greatly enhanced the offer, even though the bid still undervalues VMware.

As mentioned earlier, activists can sometimes turn themselves in hostile acquirers with their campaigns evolving into takeover bids (Sullivan & Cromwell, 2019). Indeed, activists often have their own private equity affiliates that can back up activist hedge funds when necessary. Sullivan & Cromwell's (2019) even suggests that private equity funds and shareholder activism could end up converging into one hedge fund in the future.

3. Environmental, Social, and Governance

Environmental, social, and governance issues are becoming increasingly important for all the investor types, including activists (Activist Insight, 2019). Despite the perceived discrepancy between the short-term investment horizon of activists and the longer-term horizon of ESG change, Activist Insight (2019) reports that ESG is the fastest-growing investment area, with even the largest institutional investors such as BlackRock, Vanguard, and CalPERS voting in favour of E&S matters, increasingly pushed by activists. Moreover, this growing importance of ESG for investors led proxy advisors to follow the trend; ISS launched E&S quality scores to measure the quality of companies' disclosures on the matter (J.P. Morgan, 2019).

ESG rating agencies are not new, however, their rise in the last decade led them to evolve into important economic and social actors, which strongly influence other actors' behaviour (Escrig-Olmedo, Fernández-Izquierdo, Ferrero-Ferrero, Rivera-Lirio, & Muñoz-Torres, 2019). Their expertise has become a crucial reference for companies, investors, and academia when assessing a firm's sustainability. Moreover, these agencies also give ESG ratings to mutual funds based on the fund's underlying assets (Moen, 2016).

The largest ESG rating agencies being MSCI, Blooomberg, RepRisk, Sustainalytics, and Thomson Reuters, are playing in an extremely competitive market to provide the most accurate data (Willis, Spence, & Roose, 2016). Willis et al. (2016) find that ESG data is gathered from a multitude of sources including public information, company reports, direct engagement, and regulatory filings, hence, the need for rating agencies to pool these different sources. Moreover, the ESG rating market is going through a strong consolidation wave, leading to larger agencies providing ratings on an increasing number of securities.

Almost all the recent activist expert reports mention the growing importance of ESG, emphasising "E" and "S", for hedge fund activism (Activist Insight, 2019; J.P. Morgan, 2019). These reports are in line with recent ESG initiatives launched by large activists such as Jana Partners opening an impact-investing hedge fund, Trian Partners detailing ESG concerns for his current targets, and Blue Harbour Group integrating SRI into his management tactics (Franck, 2018). Yet, very little research is available on ESG practices and returns by hedge fund activists. In a recent paper, Valentini (2018) claims to analyse ESG investing by hedge fund activists, however, his study almost entirely focuses on the most popular governance issues. Hence, to assess the impact of these recent ESG trends on hedge fund activism, research regarding ESG practices of non-hedge fund activists will further be discussed.

Hedge fund activists manage to gather funds by promising excess return to their investors, hence, investing to tackle ESG issues of the target would make sense only if it effectively generates the returns sought by activists. Barko, Cremers, and Renneboog (2017) analyse a sample of 847 global ESG activist events from 2005 to 2014 launched by a European investment management firm with 43 percent focusing on social matters, 42 percent on environmental issues, and the remaining 15 percent on governance. The authors find statistically significant positive excess returns of 0.8 percent on average, moreover, in cases where the target adopted the activist's propositions, the average excess return increases up to 4.3 percent, while failed campaigns lead to negative performances in comparison to the benchmark. Moreover, Valentini (2018) supports these results stating that the more investors consider ESG matters when constructing their portfolio, the higher the correlation with better financial performance, resulting in more activists considering it as a key campaign objective.

Recently, activist hedge fund ValueAct Capital Management acquired a stake in the largest Hawaiian supplier of energy, Hawaiian Electric Industries Inc., (Chediak & Hammond, 2018). The fund bought $50 million shares through its new environmentally focused ValueAct Spring Master Fund LP. The activist will push for the development of renewable energy as a means to counter the company's strong dependence on increasing oil prices and to prepare for 2030, when, according to study by Rhodium Group, Hawaii's energy mix is forecasted to include up to 84 percent of renewable energy (Larsen, Mohan, Herndon, Marsters, & Pitt, 2018). Of course, this ESG friendly investment goes hand in hand with the expectation to generate significant revenues; Jeff Uben, the fund's CEO, said he hoped the target will be rewarded by the markets for its push towards a more sustainable business model (Chediak & Hammond, 2018).

Part 3: Performance Analysis

Introduction

Pre-crisis literature generally supports that activists generate positive excess returns at their target in both the short-run and long-run. However, there is little literature analysing the impact of shareholder activism on a post-crisis dataset, and the few studies available, cast doubt on whether activists really have a positive impact in the long-run (Cyriac, Otto, & Wells, 2017).

Hence, following analysis uses a dataset based on 2017 and 2018 activism events to analyse the performance of shareholder activism on both the short-term and the long-term. The first part starts by describing the different data sources and the methodology used for the analysis and is followed by some descriptive statistics. The second part is centred around analysing the findings of this study in the short-run and in the long-run. Moreover, this analysis also reviews the performance of the different strategies implemented by activists. Finally, in the last part, I review the strengths and weaknesses of this performance analysis and suggest some further research on the subject.

1. Data selection and descriptive statistics

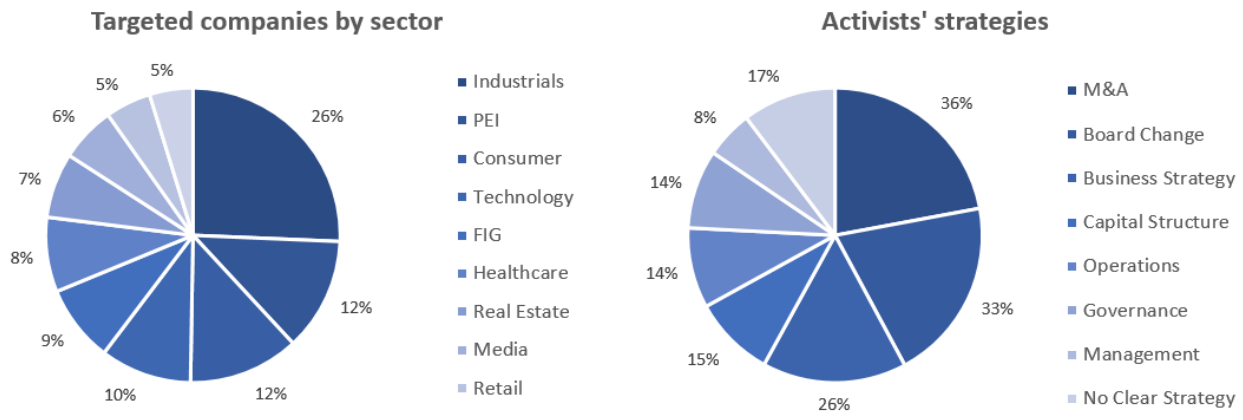
The dataset for this analysis is constructed based on Lazard's 2017 and 2018 Q3 reports, in which the financial advisory and management firm lists all the activist events of the year for companies with a market capitalisation higher than $500 million (with some exceptions) at the campaign announcement date (Lazard, 2018). At the time of constructing this sample, Lazard did not disclose the full-year report of 2018, hence, data goes as far as September 28, 2018. This results in a total dataset of 377 activism events targeted at 331 different companies, indeed, 39 companies were targeted twice, and 7 companies up to three times over the analysed period.

Samples studied by other researchers are often constructed based on 13D filings, limiting the analysis to the U.S. and to activist events in which the hedge fund acquired at least 5 percent of the company's shares (Brav, Jiang, Partnoy, & Randall, 2008). However, as hedge fund activists increasingly target larger capitalisation while purchasing fewer than five percent stakes, using 13D filings would not take into account these campaigns at larger firms. Moreover, analyses relying solely on 13D filings fail to identify the exact announcement date as the filings can be submitted as much as 10 days after the acquisition of a stake in the target. Hence, the strength of this dataset is that it contains global activist events based on multiple

sources of publicly available information such as press releases, company announcements, 13D filings, and other regulatory filings, leading to a more diverse sample with the exact campaign announcement date. Moreover, next to the targeted company, the announcement date, and the activist fund, Lazard's report already includes the market capitalisation at announcement date for every target, the activist's initial stake acquired, and the campaign's objective or strategy. 2018 report contains the sector in which the company operates, whereas for 2017 targets, the sectors were added manually based on company websites.

The different campaign objectives included in the reports are based on the activist initial announcement at the start of the campaign and include business strategy, board change, governance, M&A, capital return/structure, operational, and management change. When no information was available regarding the strategy, it was further categorised as campaigns with no clear strategy. As illustrated in Figure 4, M&A activism was the most common strategy throughout the sample's period, followed by board change and campaigns aimed at improving the business strategy. Moreover, in 39 percent of the campaigns activists pushed for more than 1 strategy. The sectors in which the companies operate are divided following Lazard's 2018 breakdown as illustrated in Figure 4, with Industrials, Power and Energy/Infrastructure, and Consumer sectors accounting for half of activism events between January 2017 and September 2018.

Figure 4: Sectors of targeted companies and activists' strategies



The split of activist targets by sector does not perfectly match Activist Insight's (2019) analysis, which reports more targets in FIG and much fewer targets in Industrials sector, however, these differences are likely due to the fact that Activist Insight's study includes more than 40 percent of targets with a market capitalisation under $500 million.

The average target's market capitalisation in the sample is $10.4 billion (median $2.1 billion), with activists acquiring on average a 6.4 percent stake (median 5.2 percent), which is in line with the 6.3 percent median reported by Brav, Jiang, Partnoy & Randall's (2008) research. As indicated in Appendix 1, the largest company targeted in 2017 and 2018, with a market capitalisation of $262.5 billion, is the conglomerate Procter & Gamble, in which Trian Partners invested more than $3 billion to reach a stake of 1.4 percent. Moreover, the highest stake purchased over the analysed period is 39 percent, confirming that hedge fund activists generally do not buy controlling stakes.

In order to assess the performance of a target before and after the activist's intervention, I collected the share price of the different companies 3 years prior to the announcement date up to the latest data available, being April 22, 2019. This data range makes it possible to assess whether activists invest in underperforming companies as well as how strongly do their targets perform after the announcement date. As the data used in this analysis is very recent, the latest campaigns of 2018 can only be analysed 6 months into the future. Hence, analyses of the 1-year performance will only include events for which the campaign started before April 22, 2018, leading to 286 activist events.

Activists are often involved in M&A transactions or push for the sale of the targeted company to capture high returns from the transaction. As a result, for 25 percent of the targeted companies from 2017 to 2018 Q3, there is no data available as they have been taken private. Historical data for the remaining 252 companies is retrieved from Nasdaq's website and Yahoo Finance using the adjusted close price to account for dividend effects.

Indeed, in order to compute the excess returns, it is crucial to benchmark the different target's returns. As presented in Appendix 2, the majority of the campaigns relate to companies listed on U.S. stock exchanges, with 45 percent of the sample listed on the New York Stock Exchange and 26 percent on the Nasdaq market. The remaining companies representing 29 percent are listed on various stock exchanges around the world, with firms traded on the London Stock Exchange and Tokyo Stock Exchange accounting for 11 percent. The daily stock price changes of the different targets have been adjusted by subtracting the daily price changes of the appropriate indexes. The benchmarks are selected based on either the main or the most relevant index of the country in which the firm is listed: for instance, the Russel 3000 index has been chosen for benchmarking the firms listed on U.S. exchanges, since most of them are small to mid-sized market capitalisation having less in common with S&P 500 members – for a complete overview of the benchmarks used, please refer to Appendix 2.

The most active shareholder activist between January 2017 and September 2018 was Elliott Management, which was involved in 39 campaigns investing more than $17 billion. The fund's largest investment occurred on April 10, 2017, when it purchased 4.1 percent of BHP, a multinational petroleum and mining company. Elliott Management was by far the busiest activist of the period, followed by Third Point Management, which engaged with 7 targets and invested a total of more than $6 billion. Other notable activists with investments surpassing $2 billion during the same period are ValueAct Capital, Icahn, TCI, Pershing Square, Trian Partners, Starboard Value, and Jana Partners.

The first step in assessing the performance of shareholder activism campaigns is to compute the daily excess returns by company following Equation 1.

$$ER_T = \frac{P_T^{Share} - P_{T-1}^{Share}}{P_{T-1}^{Share}} - \frac{P_T^{Index} - P_{T-1}^{Index}}{P_{T-1}^{Index}} \qquad (1)$$

Where ER_T is the daily excess return of the target above the performance of the adequate index and P_T is the daily value of the company's share or the index. Next, I selected the daily excess returns starting exactly one year before the activist announcement until one year after the announcement date (when available). Hence, the average excess return of the sample is always computed at a same distance in time from the activist's announcement date but not at the same date.

The next step includes computing the evolution of the excess returns over a certain period of time using Equation 2.

$$ER_{T,T+X} = (1 + ER_T) * (1 + ER_{T+1}) * \ldots * (1 + ER_{T+X}) - 1 = \left(1 + ER_{T,T+X-1}\right) * (1 + ER_{T+X}) - 1 \qquad (2)$$

Where $ER_{T,T+X}$ is the total excess return, compared to the adequate benchmark, accumulated between a certain date T and a later date T+X, and ER_T is the daily excess return.

Finally, the average excess returns have been tested on whether they significantly differ from zero; this is analysed using a one-tailed distribution t-test at a confidence interval of 95 percent: the overperformance is statistically significant (reject hypothesis zero) if the p-value is lower than 5 percent.

2. Results

The first part analyses whether targeted firms show significant short-term positive excess returns around the announcement date of the activist's campaign. As most of the researchers support that shareholder activism has a short-term positive impact on the targeted firms, this initial spike is extensively covered in the existing literature (Bebchuk, Brav, & Jiang, 2015; Klein & Zur, 2009). The forty-day window chosen to analyse short-term impact is based on the paper of Bebchuk et al. (2015) to allow for a clear comparison.

Figure 5: Short-Term Excess Return

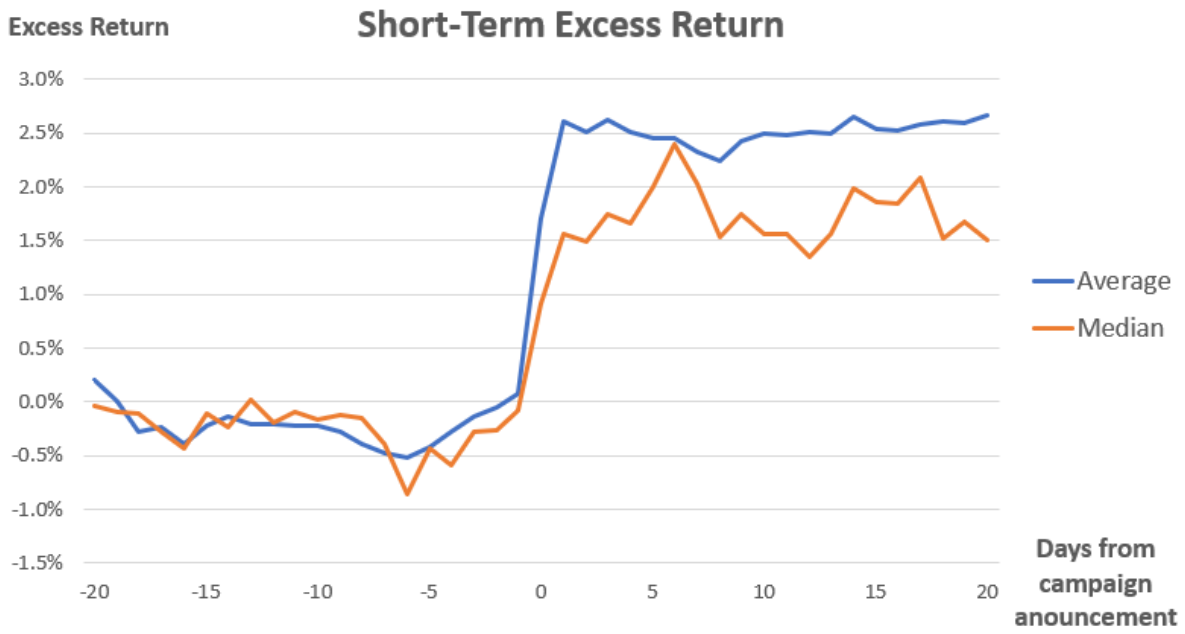


Figure 5 shows that the announcement of an activist campaign between 2017 and September 2018 generated an average excess return after the disclosure date of 2.6 percent (median 1.7 percent). As of the announcement date, the mean is significantly different from zero and positive at a one percent confidence interval until the end of the forty-day period. Moreover, the negative excess returns preceding the announcement date seen on Figure 5 are not significantly different from zero for the analysed period. Longer term pre- and post-campaign announcement date excess return will be discussed later.

These results are on the lower end of the different research previously discussed, which found short-term abnormal returns of 3 to 8 percent (Clifford, 2008; Klein & Zur, 2009; Greenwood & Schor, 2009; Brav, Jiang, & Kim, 2010; Becht, Franks, Grant, & Wagner, 2017; Bebchuk, Brav, & Jiang, 2015). These results further suggest that the investors' reaction to activism

campaigns is becoming less positive than it used to be, supporting that the post-crisis view on hedge fund activism has changed. However, the short-term positive excess returns remain strongly significant, meaning the market as a whole is still supportive and has positive expectations for activist campaigns.

Another major difference with previous studies such as Bebchuck et al. (2015) is the start date of the spike in excess returns. Indeed, as seen in Figure 5, there is barely any excess return before the announcement date, whereas the results of Bebchuck et al. (2015) presented in Figure 1 show excess returns as early as 6 days before the announcement date. This difference is likely due to the chosen announcement date; for the 2015 study the date is mainly based on Schedule 13D filings, which can be filed up to 10 days after the acquisition of a stake in the company. On the other hand, this analysis retains the exact announcement date, leading to a more accurate evolution of the perceived excess return.

This confirms that activists have a positive impact on the market capitalisation of the company in the short-term. Longer-term performance being questioned, the following section analyses this overperformance for a longer period. Bebchuk, Brav & Jiang (2015) explain that for this short-term excess return to completely disappear, the underperformance in the long-term must exceed the previously generated overperformance.

To test this assumption, the performance of the targeted companies relative to their index has been calculated in a two-year window starting one year before the campaign announcement date.

Figure 6: Long-Term Excess Return

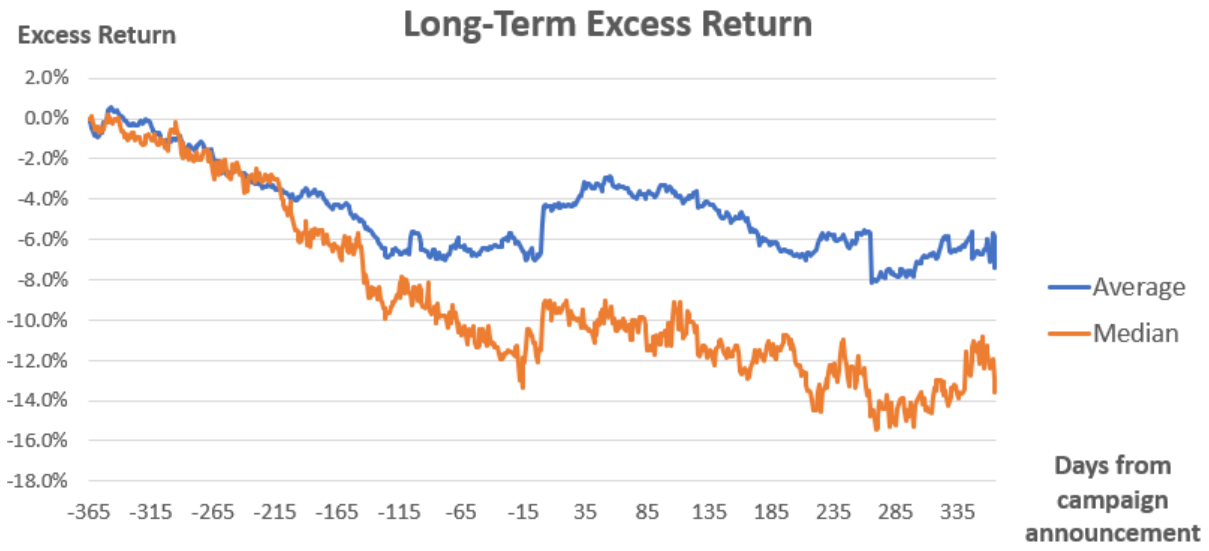


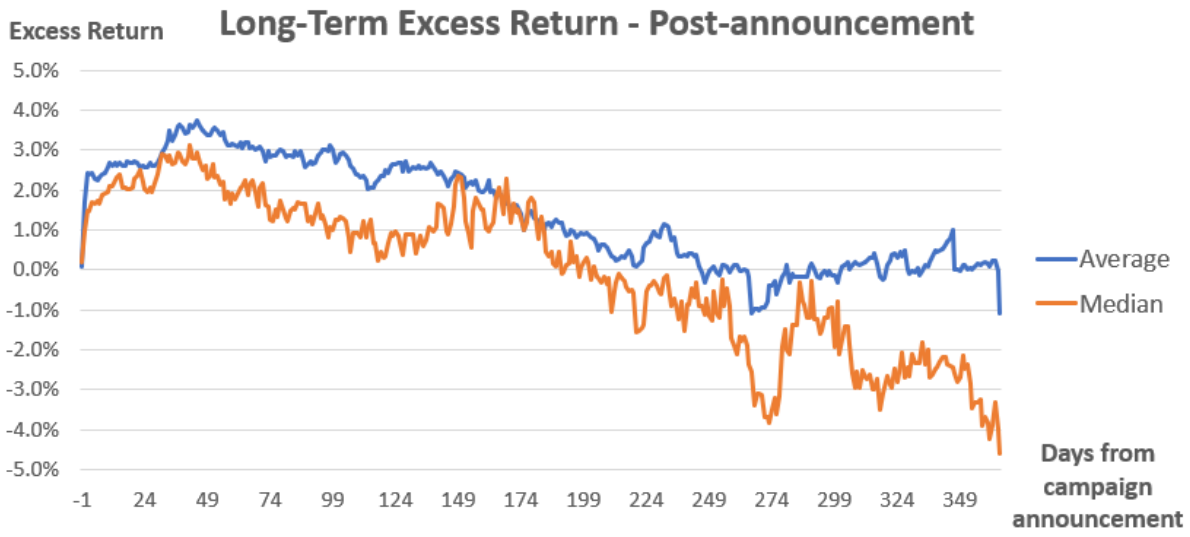
Figure 6 shows the excess performance from the 365th day before the campaign announcement. A first notable finding is that targeted companies significantly underperform in comparison to their benchmarks in the 9 months prior to the announcement date, suggesting hedge fund activists do invest in underperforming companies.

These results are in line with other researchers' findings such as Cremers et al. (2015) and Bebchuk et al. (2015) who state that activists often target firms which are underperforming prior to the campaign announcement date. Furthermore, this supports Troy's (2018) claims that the shareholder activists' target selection is in line with private equity investors, who also seek to bring change in underperforming targets.

Figure 6 clearly illustrates that the underperformance of the targeted company is the largest and most significant during the four months preceding the activist's intervention, dropping to an average of minus 7 percent (median drops even below minus 12 percent). At the activist's campaign announcement date, the share price of the target increases, reducing the underperformance it accumulated over the last year. This recovery is not strong enough to completely cancel out the entire year's underperformance, but it is enough to bring the mean back to a level that is not significantly different (negative) from zero anymore.

To analyse the performance post-announcement date, it is easier to refer to Figure 7, which takes as starting point the day before the announcement date. The short-term excess return of 2.6 percent increases up to 3.7 percent in the second month of the campaign, however, this excess return is not maintained in the longer term. Indeed, after 5 months (151 days), the excess returns start to drop and are not significantly different from zero anymore.

Figure 7: Long-Term Excess Return - Post-Announcement



Results so far suggest that, on average, hedge fund activists do not improve the long-term performance of the often underperforming firm they target. Moreover, according to different research, activists hold their long position for 1 to 1.8 years (Brav, Jiang, Partnoy, & Randall, 2008; Carrothers, 2017). Therefore, in 2017 and 2018, based on a 1 year holding period and the results presented in Figure 7, on average, activists have underperformed in comparison to relevant indexes.

These findings are supported by the annual returns of the largest activists. Whereas the S&P 500 decreased with 6.2 percent in 2018, Activist Insights (2019) reports that Elliott Management, the largest activist of 2018, had an average return of minus 10.3 percent on its targets' portfolio, underperforming the U.S. index. Other prominent activists faced similar results, with the exception of Starboard value, overperforming the market with a 2018 annual return as high as 11.8 percent. Analysis of activist's revenues in 2017 leads to a similar conclusion; the S&P 500 showed a strong yearly performance of 19.4 percent, whereas the biggest activists of the year Elliott Management, Trian Partners, and Third Point Partners saw their portfolio underperforming the benchmark with returns of respectively 13.6 percent, 2.3 percent, and 18.5 percent (Activist Insight, 2018).

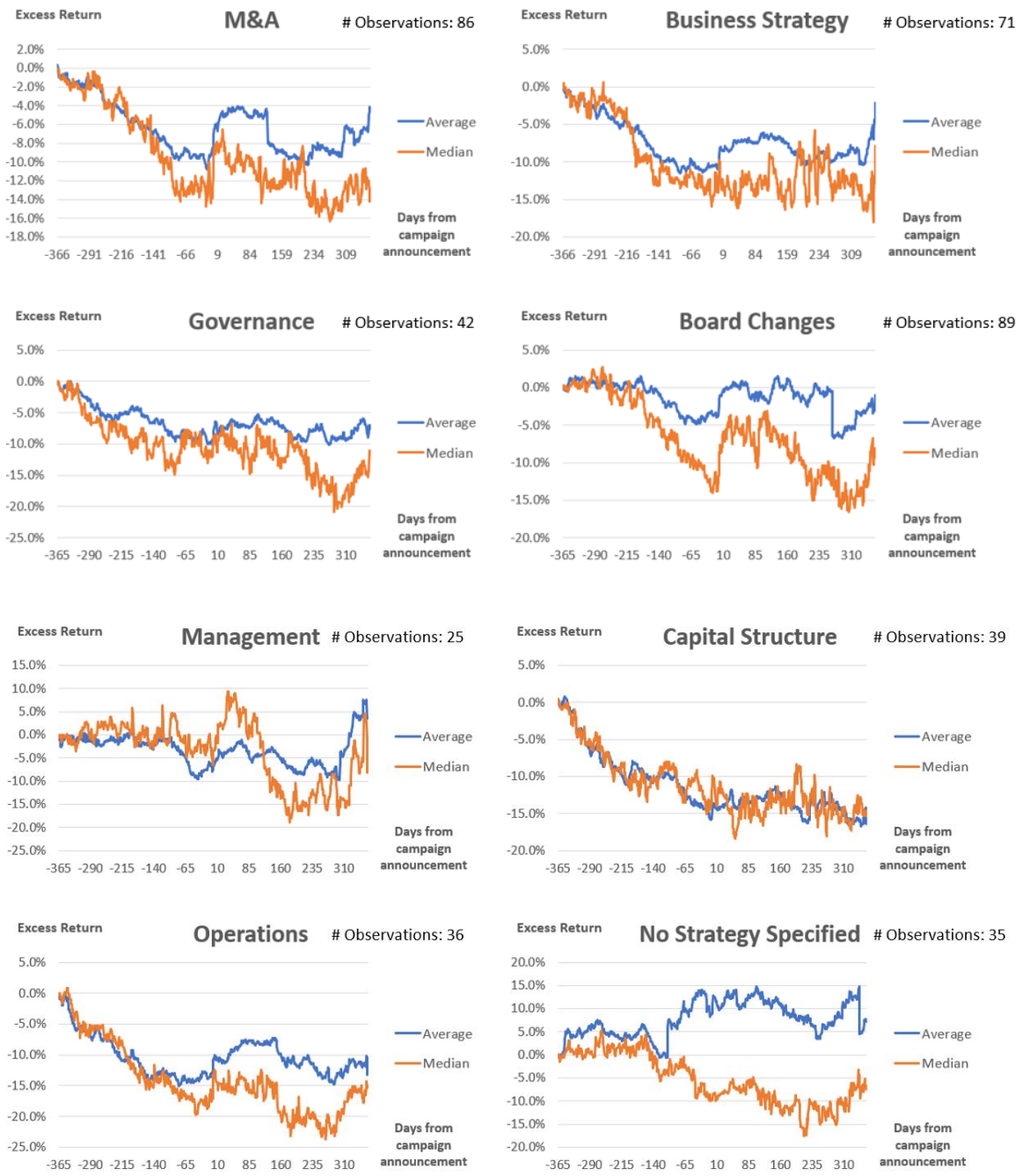
The next analysis tries to determine whether the initial strategy announced by the activist has an impact on the target's share performance. Indeed, different studies suggest that depending on the reason behind the activist's campaign, the performance will differ. For instance, Hinkel et al. (2015) find that M&A based activism delivers higher abnormal returns than other strategies. 7 different strategies announced by activists have been tested along with the case in which the activist did not specify any strategy.

As reported in Figure 8, the best performing campaigns are related to M&A and business strategy; these strategies generated the highest excess return in the first three months after the campaign announcement date, respectively 5.5 percent and 4.5 percent. Moreover, these two strategies along with governance changes were positive and significantly different from zero for the 3 to 4 months following the start of the campaign, which is the longest period of time with significant positive performance among all strategies. The next best performing firms are targeted by campaigns in which the activists pushed for changes to the board of directors, capital structure improvements, and operations, with results significantly positive during the 50 to 80 days succeeding the campaign announcement date. Indeed, changes in capital structure and operations are well-known for their short-term positive contribution, yet, long-term performance improvements are not as obvious. Finally, the categories showing the worst impact on the targeted firms are campaigns aimed at changing the management as well as campaigns that did not specify any specific objective. Surprisingly, as opposed to all the other

strategies, firms targeted with these objectives do not show any sign of clear underperformance before the announcement date.

Please note that the high difference between the average and the median for events with no specific strategy is caused by several outliers showing a very high overperformance; when adjusting for these outliers, the average decreases and follows the median, but is not significantly different from zero.

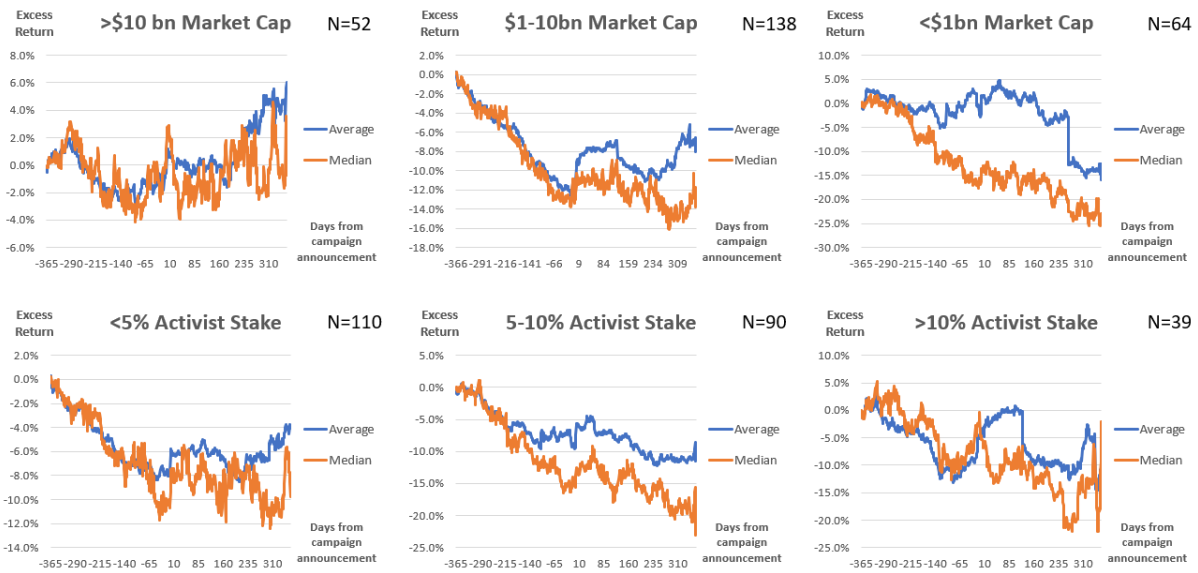
Figure 8: Long-Term Excess Performance by Activists' Announced Strategy



Finally, using the same methodology as for the different activists' strategies, it has been analysed whether the firm size or the stake purchased by activists have an impact on the overperformance of the target firm. The hypothesis made is that larger companies might have better defence mechanisms to fend of activists, limiting the performance improvement they can generate. Moreover, one can expect that activists purchasing a higher stake will have more influence, leading to higher excess returns.

First, this analysis focuses on the impact of the market capitalisation of the target on the overperformance. As shown in Figure 9, the dataset is split into firms with a market capitalisation exceeding $10 billion (52 firms), between $1 and $10 billion (138 firms), and under $1 billion (64 firms). A first notable result is that, while activists usually target underperforming companies, the largest companies did not significantly underperform prior to the announcement date, suggesting that larger companies might be targeted for other reasons than underperformance[1]. Moreover, the largest companies showed the lowest significant excess returns of 1.3 percent maintained over a period of only two weeks. On the other hand, activists' intervention generated significant excess returns for both medium-sized and small-sized companies of respectively 3.5 and 4.0 percent, sustained over a period of three to four months. These results suggest that activists are less successful when targeting larger companies.

Figure 9: Long-Term Excess Performance by Market Cap and Stake



[1] The smaller firms of the sample only underperform before the announcement date when outliers are removed.

The bottom part of Figure 9 illustrates how the stake purchased by activists influences the excess return. The firms with the lowest percentage of activists among their shareholders show an average significant excess return of 1.7 percent over a period of 65 days. Companies where shareholders acquired 5-10 percent of the shares generate significant positive excess returns of 3.6 percent and maintain this period for almost three months, outperforming the first group. The group of companies where shareholders had more than 10 percent of the shares shows an even better performance with returns of 4.6 percent sustained over 4 months.

Combining the results of the different analysis, one can find that activists purchasing a high percentage of the shares of a smaller company with the aim to challenge current M&A deals or to change the business strategy, generate the highest excess returns. Furthermore, it is important to keep in mind that the excess returns generated by activist campaigns show a high volatility. There are cases of very successful campaigns in all of the analysed scenarios.

3. Critical assessment and opportunities for future research

The combination of a thorough review of the existing literature of hedge fund activism with the analysis of the latest reports and recent press releases is one of the strengths of this thesis. Recent literature regarding shareholder activism exists, however, the majority of the activism events analysed dates back to before the crisis. Hence, as the investment world along with hedge fund activism greatly evolved during this last decade, this analysis serves as a refreshing view on the matter.

Furthermore, activists' campaigns targeting ESG issues of companies is a recent phenomenon and has barely been covered in the existing literature. Indeed, passive institutional investors sometimes push for ESG changes, however, hedge fund activists have a tougher and more radical approach to bringing chance to the targeted firm. Due to its recentness, the number of environmental and social activism events is low, limiting the possibility to analyse potential overperformance generated by ESG activism as a strategy. However, the growing number of ESG events will make it possible to analyse this performance in the future.

The sample of activism events used in this research is both a strength and a weakness. On the one hand, the recentness of the events analysed offers an updated view of the current performance by hedge fund activists. Moreover, as opposed to some research solely focusing on U.S. SEC 13D filings, the dataset includes all the global activism events of firms with a market capitalisation above $500 million. Yet, on the other hand, the recentness is also a weakness as it does not allow to analyse the performance up to three years after the campaign announcement date. An additional potential improvement is linked to the sample size, indeed, a more complete analysis taking all the post-crisis activist events since 2011 into account would generate a more objective view of hedge fund activism.

Finally, this thesis can serve as a guide for investors seeking to invest in activist hedge funds, managers that wish to avoid and prepare for potential campaigns aimed at their company, as well as companies currently facing activists pressure that wish to understand how to best react.

Conclusion

Whereas institutional activism usually comes from passive investors that suddenly want to initiate changes to their portfolio's underperforming company, this thesis focuses on hedge fund activists, which deliberately purchase a stake in companies, try to implement their vision or strategy to improve the company's performance and generate abnormal stock returns. Even though hedge fund activism has its root in the U.S., it is gaining popularity in the rest of the world. Also, activists diverge from their usual preys and target larger and more complex entities than they have done before.

This research presents several company characteristics that increase the likelihood of being targeted by shareholder activists. Indeed, similarly to the targets of private equity funds, underperforming companies often attract activists that want to push the company back to normal or higher performance levels. Other elements activists might be looking for, include conglomerates that trade at the so-called conglomerate discount, firms neglecting the importance of ESG issues (with a specific focus on governance issues related to the management), the capital structure or the board of directors, and companies involved in a M&A transaction. Moreover, as activists often initiate a shareholder vote, they might prefer firms where they can find allies such as other hedge fund activists or institutional investors known to be supportive of activists.

An activist's path to influence can become very expensive if the conflict between the management and the hedge fund escalates. Indeed, if no settlement agreement is reached after the private and public arguments between the two parties, a campaign can end up in a proxy contest, pushing the cost of the entire campaign up to an average of $10 million. As a last resort, activist can initiate a lawsuit against the target when they do not obtain the required materials or discussions with the firm. Hence, in order to avoid the consequences brought by an activist campaign such as distraction from the core operations, high costs, and the negative impact on employee morale, managers should prepare for activists by addressing issues that could attract them as well as establishing a clear response plan if an activist enters the shareholder base. As activists often have good ideas that can lead to better performance, managers should, if possible, try to collaborate.

Activists claim that their changes generate high value for the shareholders in both the short-term and long-term. Whereas a consensus can be found regarding the short-term overperformance following the activist's campaign announcement, the long-term abnormal returns are often contested. Moreover, the results between analyses working on a pre-crisis

dataset clearly differ than studies on post-crisis datasets. The former often supports long-term overperformance while the latter is less conclusive.

Through the analysis of a recent dataset based on activism events from January 2017 to September 2018, this thesis confirmed the existence of a significant short-term overperformance, however, this overperformance disappears after approximately 5 months, casting doubts on whether activists really improve the long-term performance of companies. Moreover, this analysis is complemented by the review of 2017 and 2018 yearly results of activist hedge funds, which also underperformed their benchmarks.

Furthermore, the different changes implemented by activists are broken down into strategies addressing the target's capital structure, the firm's governance, board, management, the overall strategy of the firm, the company's operations, and activism against M&A. The results of this analysis support the view that M&A and strategy are the issues addressed by activists that generate the most value, closely followed by governance changes. The worst performing strategies relate to firms where activists want to change the management or without a clear strategy.

Finally, the size of the target and the stake purchased by the activists can greatly influence the generated excess return. This analysis supports that activist should avoid targeting too large companies. Indeed, firms showing the best performance after the activist's intervention have market capitalisation below $10 billion. Moreover, when activists purchase a higher stake, the target usually generates higher excess returns.

All in all, with investors increasingly focusing on passive investments such as exchange-traded funds that do not require any engagement towards the firms, hedge fund activists play an important role in the financial markets as they put pressure on management to better perform. Not only do they impact their targets, but other firms also improve their overall strategy and governance by fear that an activist would get involved in its shareholder base. Hence, even though activists do not always generate the promised abnormal returns, they are crucial actors with a positive impact on stock market performance.

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Appendix

Appendix 1: Target's market capitalisation and activists' invested capital

Percentile	Activists' Stake	Market Capitalization	Invested Capital ($ million)
Minimum	0.10%	193	1
5%	0.50%	509	12
25%	2.70%	983	48
Median (50%)	5.20%	2,124	111
75%	8.80%	7,073	324
95%	16.90%	52,221	1,059
Maximum	39.00%	262,528	7,171

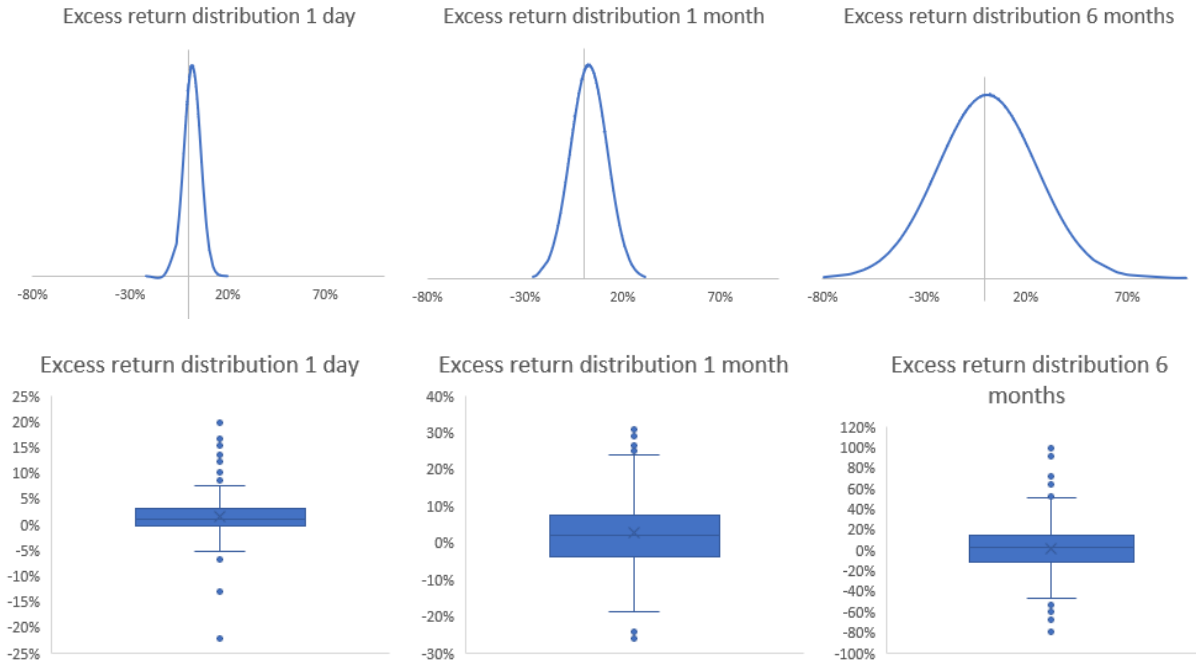
The highest activists' stake of 39 percent represents the pooled investment of Elliott Management (20 percent), BlueMountain Capital (11 percent), and Avenue Capital (8 percent) in Ocean Rig, an operator of oil platforms (Benny & Kalluvila, 2017). As discussed, the largest target of the sample with a market cap of $262.5 billion is the conglomerate P&G, in which Trian Partners acquired a 1.4 percent stake. Finally, activist TCI invested more than $7 billion in the investment company Altaba to reach a stake of 9.7 percent.

Appendix 2: Stock exchanges and chosen benchmarks

Stock Exchange	Index Used	Number of targets	Percentage of total
NYSE	Russell 3000	127	45%
Nasdaq	Russell 3000	74	26%
LSE	FTSE 100	20	7%
Tokyo	Nikkeii 225	10	4%
Toronto	GSPTSE	7	2%
Xetra	DAX 30	7	2%
Milan	FTSE MIB	4	1%
Swiss	SMI	4	1%
KRX	KOSPI	3	1%
Madrid	Ibex 35	3	1%
Paris	CAC 40	3	1%
Vienna	FTSE MIB	3	1%
Amsterdam	AEX	2	1%
ASX	AXJO	2	1%
Stuttgart	DAX 30	2	1%
Berlin	DAX 30	1	0%
Brussels	Bel 20	1	0%
Helsinki	OMX Helsinki 25	1	0%
Lisbon	PSI 20	1	0%
Mexico	IPC	1	0%
Munich	DAX 30	1	0%
Prague	PX Index	1	0%
Sao Paolo	Ibovespa	1	0%
Taiwan	TAIEX	1	0%
Tel Aviv	TA-125	1	0%

The indexes are chosen to best represent the market in which the companies compete. Germany and the U.S. have more than one exchange, however, the same local index has been used. Moreover, to crosscheck the obtained results, the entire analysis has also been performed using the S&P500 index, which delivered similar results with a slightly lower short-term overperformance.

Appendix 3: Distribution of the excess returns from campaign announcement until 1, 30, and 150 days later



As could be expected, the wider the time window, the higher the variation in excess return. However, the largest tail remains on the right side, supporting that the average excess return is positive. Moreover, the boxplot on the right shows outliers with more than 80 percent positive and negative returns, suggesting that the performance of activists can widely vary depending on the market conditions.