

Talent Management

Proxy Fight Settlements

By Jason Frankl and Steven Balet

Activist investors continued to put pressure on boards and management teams across America this proxy season. Funds of all sizes—some with dedicated activist strategies and some with no activist history—launched over 400 campaigns in the United States, on track to exceed 645 domestic campaigns in 2016. Very public, direct campaigns for CEO removal were the dominating theme. CEOs were pushed out at even the largest companies, such as Arconic, Rent-A-Center, and CSX Corp., to name a few.

Activists gained confidence in bringing their concerns to the public, as illustrated by the 72 proxy fights that have occurred so far in 2017, a 20 percent increase compared to the same period in 2012. This pressure has caused some companies to acquiesce to activist demands and at times accept unfavorable settlement terms instead of fighting through a proxy contest.

CEO Turnover After an Engagement

FTI Consulting's Activism and M&A Solutions practice looked at more than 300 activist campaigns between 2012 and 2015, and found that in circumstances where an activist gains board representation, CEOs were replaced at three times the normal rate within a 12-month period. Simply being targeted by an activist, without them attaining a board seat, caused the CEO replacement rate to double the norm in a 12-month period. Replacing management typically means replacing the strategy that the activist disagrees with for one they like. In situations where an activist gains a board seat, it is more likely that the activist's influence in the

CEO search process will yield a candidate who favors the activist's strategy. Our study (available at www.ftiactivism.com) included a broad array of both underperforming and outperforming companies; therefore, these turnover statistics cannot be credited to activist investors in every case. Regardless, the significant jump in CEO turnover rate in the one-year period after an activist nominee joins a board, or merely publicly targets a board, should be cause for concern for management teams.

Furthermore, of the 50 companies that negotiated settlement agreements in 2016, 11 had a management change later in the year. These 11 situations were not all classic activist investor campaigns; however, many of the settlement agreements that CEOs accepted last year preceded their job loss. It is well understood that most management changes at that level are complicated and lengthy. Private negotiations within the company, and between the activists and companies, may provide more insight into whether the CEO departure was planned even prior to an activist engagement.

Short-Termism

In the current environment, it is not always clear whether institutional investors or activist funds are seeking change. The highest-profile activist investors often approach institutional investors prior to launching their campaigns—a substantial change from chillier activist relationships with institutional investors a decade ago. Today, activist investors depend on institutional support in campaigns. However, when it comes to settling with activists, institutional funds have recently

held a more pro-management stance. Funds such as State Street Global have voiced concern that the shortened period from campaign launch to settlement is causing companies to accept settlement terms that are too harsh and do not take into account the prerogative of other shareholders.

Suggestions for Companies

The best defense against activist investors is a good offense, which always includes a preparation plan. Our report on the basic steps companies can take to prepare for and defend against activist investors dives deeper into this subject. However, aggressive activist campaigns may not afford companies enough time to make the proper preparations. When a company is in this position, management should remain reluctant to welcome activist directors. The increased likelihood of a management ouster should stand as encouragement to remove board seats as a bargaining chip in discussions with activists and seek a pro-management outcome.



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