Eye of the Storm: Preparing for the Next Surge of Shareholder Activism

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Publicly traded U.S. companies are in the eye of the storm. Shareholder activists have been largely (and strangely) quiet in the month of March as the COVID-19 pandemic has challenged our society and economy. But our analysis and understanding of activist investor dynamics suggest they will come storming back in the coming months as the first signs of economic recovery—or at least signs of the market bottom—emerge. While the first three months of the year put activism on its lowest trajectory since 2012, we are advising our clients to use this lull to prepare for a resurgence of activity in the second half of 2020 or early 2021.

First, let’s take a step back. Shareholder activism has become a fact of life for leaders of U.S. companies. Campaigns have grown steadily since the Great Financial Crisis, peaking in 2015 and overall on a consistent 6-8% annual growth trajectory. We estimate at least one-third of leading companies in the United States have been targeted at some point by an activist, and in recent years activists have begun taking positions aggressively abroad, notably cash-rich Japan as well as in the UK and major Northern European countries.

The past few weeks, as COVID-19 grew into a pandemic that seized up the global economy, have been an exception. Even though stocks plummeted in March, with many indices down 20-30% and at times more, activism campaigns focused on U.S.-based companies also stalled.
While one might expect shareholder activism to surge when stock prices fall, there are many reasons activity actually has slowed. Equity market dislocations have stressed hedge fund portfolios including those of activists. Funds experiencing significant drawdowns may lack dry powder to go after new targets because of redemptions. Some funds with firepower are doubling down on existing positions (e.g., Icahn/Occidental Petroleum). And, perhaps most fundamentally, activists want to avoid “catching a falling knife.” At its heart, activism is an attempt to make an asymmetrical bet – to identify a company with relatively strong fundamentals that is undervalued (for some reason) by the capital markets, and to urge an alternative thesis to create shareholder value. It is hard to play this game in an environment of extreme market volatility, daily double-digit declines and occasional electronic halts to trading.

A look back at the past 11 years underscores this dynamic. Activists stayed on the sidelines and waited as companies suffered the largest losses in 2008-09. Perhaps not surprisingly, they also avoided campaigns after periods of the largest market rebounds. Activism has been at its strongest in periods of market stability, and in catching modest-to-strong bull market tailwinds.

But companies need to be prepared for the resurgence. While there are many factors that have fueled activism in the past decade, perhaps the most important is the support it has received from more traditional passive and active investors. In the latest BCG Investor Survey, conducted in November/December 2019, two-thirds of investors said that they would welcome activists at companies they are invested in and a full 70% said that they would at least privately support activists. And that was before the current crisis wiped out 20% of their investments.

At BCG, we are advising our clients to prepare for a surge of activist engagements as the markets “find bottom” and especially as signals of a recovery start to overtake the torrent of reports detailing the country’s struggles to cope with the virus.

What does this mean? To start, it’s important to make a sober assessment of your business performance and outlook, portfolio of businesses, corporate and operational strategies, and recent trading dynamics. Some questions to ask:

- How have your results fared relative to competitors? To customers and suppliers? To others in the ecosystem? Activists will look for companies with relatively strong fundamentals and relatively poor market performance. How your company handles the crisis will be an additional metric by which you will be measured against your peers.

- To what extent are you in a more vulnerable sector (e.g., airlines, travel & tourism).
physical retail, oil & gas) as opposed to a relatively sheltered or even advantaged sector (e.g., internet services / digital experiences / home delivery, biopharma, consumer staples)? Activists will hit pause on many of the former, especially, but may soon resume new campaigns in the latter (e.g., Starboard Capital’s announced position in Convervaault Systems on March 30th).

• In what condition is your balance sheet? There is a tricky balance to play here. Obviously, companies need to shore up their cash flows and cash management to survive a crisis that will last an untold number of months. But history has shown, when the market stabilizes, activists will pounce on companies with cash balances and balance sheet capacity. Clients need to be prepared to manage dry powder when the market begins to turn.

Additionally, this may be the right time to conduct a full strategic and operating review, which can uncover a host of other opportunities to create value by addressing core issues in the business or financials. In the spirit of “never waste a crisis,” we are seeing clients get out ahead of a prospective activist thesis and take this opportunity to (for example):

• Reshape operating models and organization structures,

• “Zero base” their indirect spend,

• Invest in inside sales or other low-touch high-velocity sales models,

• Cut capital spending on low-return or marginal projects, and

• Review a long list of working capital levers to generate days or even weeks of much-needed cash.

In short, the best defense is a good offense.

We appreciate every company’s starting position is different, and that organizations may be anywhere on the spectrum from existentially threatened to relatively advantaged. Each strategy must be tailored to the specific competitive and financial context. But while activists may be less a part of the immediate conversation, we believe that is likely to change – in a big way – as the global economy takes steps to right itself.

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