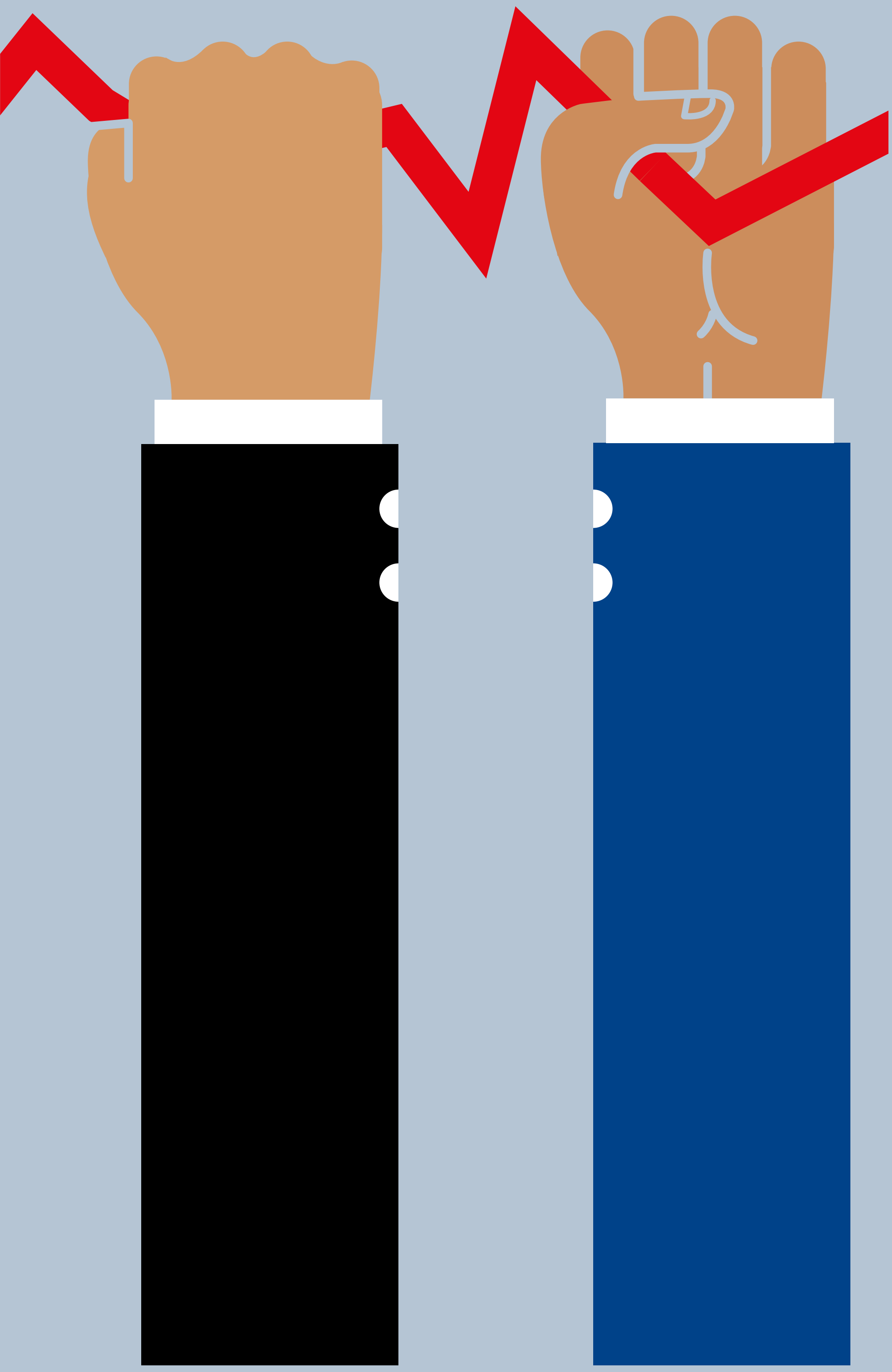
BRUNSWICK REVIEW

spotlight

on SHAREHOLDER ACTIVISM



CENTER OF THE STORM
Marty Lipton isn't quitting his lifelong passion: defending boards

BLACKROCK'S QUIET POWER
Michelle Edkins maintains it's all about the long term

THE ACTIVIST SPEAKS
Bill Ackman says boards need the boost that activists can provide

FROM THE US WITH LOVE
American-style activism casts a long shadow

Plus
BRUNSWICK INSIGHT
Retail investors side with activists

The surge of shareholder activism sweeping through the corporate world is only accelerating, and virtually no company is immune. Companies need to consider how they would handle a challenge for control. Preparation is essential. The antagonists are sophisticated players who have done their homework and revel in playing offense.

Significant stakes can be amassed under the radar. The first indication that you are a target may well be when a 100-page-plus white paper lands on the boardroom table – or a tweet moves your stock price dramatically. And you can be sure the activist is already wooing your other investors. In this *Spotlight* issue of the *Brunswick Review*, we feature interviews with some of the most influential voices in the debate.

Marty Lipton, the grandfather of corporate defense, is as vocal as ever about what he sees as the harmful effects of shareholder activism. BlackRock's Michelle Edkins discusses engaging with both companies and activists, while leading US hedge fund manager and activist Bill Ackman shares his views. We look at how shareholder activism is affecting corporate governance inside the boardroom and consider how CEOs and management teams can effectively respond.

We hope you enjoy this edition, and welcome your feedback.

STEVE LIPIN – *Senior Partner, US, Brunswick Group*

BRUNSWICK

Brunswick is an advisory firm specializing in critical issues and corporate relations

Spotlight on shareholder activism is the first in a series that complements the *Brunswick Review*, a journal of communications and corporate relations. Each *Spotlight* will focus on a single topic that represents a challenge to corporate leadership around the world

Barbarians inside the gate

Activists are posing bolder, smarter challenges, says Brunswick's RADINA RUSSELL

Activist investors are driving fundamental change in boardrooms across the US, and that pressure is increasing dramatically. The number of activists has more than doubled since 2010, with upstarts building on the success of the pioneers. The number of companies targeted increased 18 percent between 2013 and 2014.

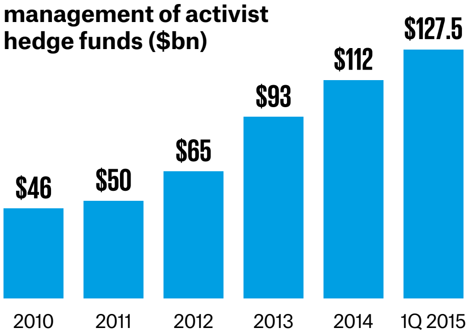
As activism has grown, campaigns have become both more sophisticated and more audacious. Where activists once sought a simple return of more cash to shareholders, they are increasingly calling for new board members as a way to drive operational and structural change. With greater assets under management, they can take on larger targets. In 2014, there were 21 campaigns against companies with a market capitalization above $10 billion; in the first half of 2015 alone, there were 18.

Along with the shift in motivations and approaches, the success rate of activist campaigns has increased. In 2014, activists won, partially won or reached a settlement in 73 percent of the campaigns they launched – a staggering increase over the 53 percent "success" rate in 2010.

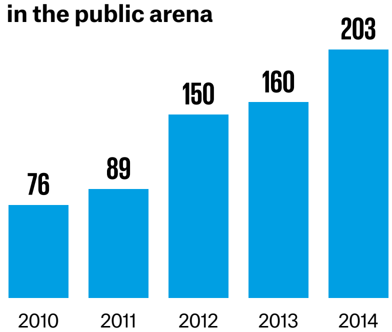
Given the changes, companies would be smart to be equally savvy and prepared for the challenges that could come.

RADINA RUSSELL, a Brunswick Director, leads the activist preparedness practice in the New York office.

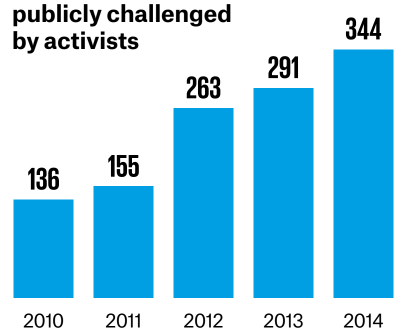
Total assets under management of activist hedge funds ($bn)



Number of activists in the public arena



Number of companies publicly challenged by activists



Source: Hedge Fund Research / Schulte Roth & Zabel / The Activist Investing Annual Review 2015 / Activist Insight / Valence Group

THE ORIGINALS

- Pioneers
- Run aggressive, public campaigns

including

Icahn Enterprises – Carl Icahn

Mesa Petroleum – T. Boone Pickens

Trian Partners – Nelson Peltz

NEW BREED

- Follow the Originals' style
- Seek big impact

Starboard Value – Jeffrey C. Smith

Greenlight Capital – David Einhorn

Jana Partners – Barry S. Rosenstein

Pershing Square – Bill Ackman

Elliott Management – Paul Elliott Singer

SONS OF ACTIVISTS

- Mentored by well-established activists, now on their own

Corvex Management – Keith Meister

Marcato Capital Management – Richard T. McGuire

Sachem Head Capital Management – Scott Ferguson

COLLABORATIVE / CONSTRUCTIVIST

- Work with management behind the scenes
- Rarely use public pressure

Blue Harbour Group – Clifton S. Robbins

Glenview Capital Management – Larry Robbins

ValueAct Capital Management – Jeffrey W. Ubben

SPECIAL INTEREST / INSTITUTIONAL

- Seek environmental, social and corporate governance reform
- Partner with activists for change

California Public Employees and State Teachers Retirement Systems (CalPERS and CalSTRS)

Change to Win (CtW) Investment Group

ICONS: MICHAEL BRANDON MYERS

Corporate defender

Legal guru and champion of board power MARTY LIPTON tells Brunswick's STEVE LIPIN why he has battled for half a century against the ills of shareholder activism

Marty Lipton remembers the first time he noticed a contest for the control of a corporate board: a newspaper "fight" ad he saw while still a student at law school at New York University. Robert Young, from a Texas family, was waging a proxy fight for control of New York Central, a major East Coast railroad, against its establishment board, and pulled out the stops with a big PR campaign in the leading New York City newspapers.

"The ad said, 'A hog can cross the country without changing trains – but you can't!'" Lipton recalls. "After law school, I was actually intending to teach. I got sidetracked."

That sidetrack led to a career as a legal protagonist and corporate adviser on board rights. Lipton is the inventor of the "poison pill" strategy used to thwart hostile takeovers, and the author of a seminal 1979 article on board responsibility to other stakeholders besides shareholders. In 1992, he co-authored the paper, "A modest proposal for improved corporate governance," which became the template for basic corporate governance principles that were adopted in the 1990s.

He remains committed to the idea that boards should not be hostage to a "shareholder-centric" model that forces short-term thinking, results in layoffs instead of investments, and does tremendous harm to the US economy.

In a conference room at the firm he co-founded, the 84-year-old adviser to boards, CEOs and management teams is smartly dressed in dark pants, a crisp white shirt and red tie. He makes clear he is not slowing down either in his law practice or his advocacy work.

"I still work 24/7," he says.

How does activism now compare to the early days?

To the extent you'd call it activism in the 1950s and '60s, it was very different. Successful entrepreneurs, successful operators of businesses, decided that they could run an existing enterprise better than whoever was in charge. They staged proxy fights for control.

These were the early days of conglomeratization, so you also had attempts to acquire companies forcefully by buying stock in the market and threatening to take control in order to build a larger company. By the end of the 1970s, you had a large collection of conglomerates formed.

What you might call activist entrepreneurs started to show up on the scene around the same

MARTY LIPTON

A founder in 1965 of Wachtell, Lipton, Rosen & Katz, Martin Lipton is an important shaper of US corporate defense legal practice and is considered one of the deans of mergers and acquisitions law. He is most famous as the creator of the "poison pill" shareholder rights tactic in the 1980s to defend companies against hostile takeover bids. *The National Law Journal* has included Lipton on its "100 Most Influential Lawyers" list consistently for the past 30 years. According to *American Lawyer*, his firm has remained the "runaway leader in profits per partner" since 2000.

PORTRAIT: PETER FIELD

time. They typically had one of three objectives: to force targets to be acquired, to gain control of the company and liquidate it at a profit, or to be greenmailed out of their position. The quintessential example is T. Boone Pickens, who decided he could explore for oil on Wall Street – buy it for less than it cost to drill for it.

When did it become acceptable for an established company to make hostile bids?
Probably the threshold was 1979, with the hostile bid by American Express for McGraw-Hill: well-established companies on both sides, with Morgan Stanley defending McGraw-Hill and Lazard's Felix Rohatyn representing American Express. That shone a spotlight on this activity. It drew more attention than any other hostile bid up to that date and started the dispute about the economic effects of hostile activity – and what the legal rules should be. Up to 1979, and even after, there was great doubt about the legal rules around a hostile bid.

I wrote an article in 1979 called "Takeover bids in the target's boardroom," to argue that the law permitted boards of directors to defend against hostile takeover bids. The Chicago school of economics thought – at most – that all a company ought to be able to do is auction itself off to the highest bidder. A company should not be able to defend itself. Until 1985 [in the court cases of Unocal v. Mesa Petroleum and Moran v. Household], it was not established legally that a company was able to defend itself.

What has happened since then?
We have had a raft of activity supporting shareholder-centric governance. ISS and the Council of Institutional Investors started in 1985. We had Sarbanes-Oxley, Dodd-Frank, and a series of Securities and Exchange Commission and Department of Labor regulations. You could say I have been losing steadily since 1985 until a few years ago, never having given up, and continuing to write articles and make speeches.

Where are we now?
A few years ago people began to recognize that activism was having a serious adverse impact on the economy as a whole, that the accretion of shareholder power was a direct cause of the financial crisis in 2008, and that the pressure on companies to meet Wall Street expectations on earnings was encouraging corporations to take on very high risk, to go to the line, and in some cases over the line. There was a beginning of recognition that there was something wrong here. In 2008, there was a general recognition, particularly by bank regulators, that shareholder-centric governance created problems.

After that, there were the beginnings of support, some of it in academia, for the stakeholder concept: that the board's obligation was to consider the long-term interests of investors and the interests of other stakeholders, including customers, suppliers, employees, the community and the economy as a whole.

Is there a backlash brewing?
The first Wall Street recognition was from Larry Fink at BlackRock, who saw that activism restrains investment for long-term growth of profits and market price. Now he's been joined by Bill McNabb at Vanguard, by State Street, by Roger Ferguson at TIAA-CREF, so there is a significant Wall Street awareness of the adverse effects.

A series of economic studies, two of which have come from Europe, showed that activism – short-termism, shareholder-centric governance – is responsible for a very material drag on GDP growth in the US, UK, Netherlands, France and Germany. If companies don't invest you're not going to get an increase in productivity, you're not going to create employment – you're not adding to the economy. It doesn't take statistics to show that. It's plain, ordinary common sense. And people are beginning to have common sense.

You have seen some votes where the institutions have voted against the activists?
If it wasn't for BlackRock, State Street and Vanguard, the DuPont case [where shareholders sided with management against Nelson Peltz's attempt to split up the company,] could have gone the other way. The index funds clearly are recognizing that it's not in the long-term interests of their ultimate beneficiaries. You may get a profit in one stock, but in a thousand-stock portfolio, you have to worry about the other 999. In the long run, you may hurt your portfolio overall by supporting an activist in one stock.

Democratic presidential candidate Hillary Clinton proposed a higher capital gains tax rate

Greenmail, a play on the word blackmail, refers to stopping a hostile investor's campaign by paying a large premium to buy back his stake in the company

The Chicago school refers to followers of Milton Friedman (1912-2006), who advocate for freer markets and minimal government intervention

Institutional Shareholder Services, or ISS, advises hedge funds on the use of proxy votes to increase the value of the shares they own

The Council of Institutional Investors is an advocate for corporate governance to enhance the rights of shareholders

Sarbanes-Oxley and Dodd-Frank increased transparency requirements of corporate boards. Sarbanes-Oxley forces companies, among other things, to put non-executive directors on corporate audit and compensation committees. Dodd-Frank subjects executive compensation to a shareholder vote

The Department of Labor introduced the Employee Retirement Income Security Act (ERISA) in 1974, which requires pension funds to vote their proxies in the best interest of their employee members

for short-term investments. Her views seem similar to yours, don't they?
They do, but I'm somewhat doubtful. Taxes cannot stop activism. Taxes don't mean anything to them, there's so much money to be made. The activists are not going to stop because they're paying 50 percent instead of 25 percent. It's good in that it sends a signal and it may help to moderate this activity – but it's not enough to stop it.

So what can be done?
We need to rethink corporate governance. The board of directors should determine the strategy of a company. We've taken that away and put the power into the hands of shareholders.

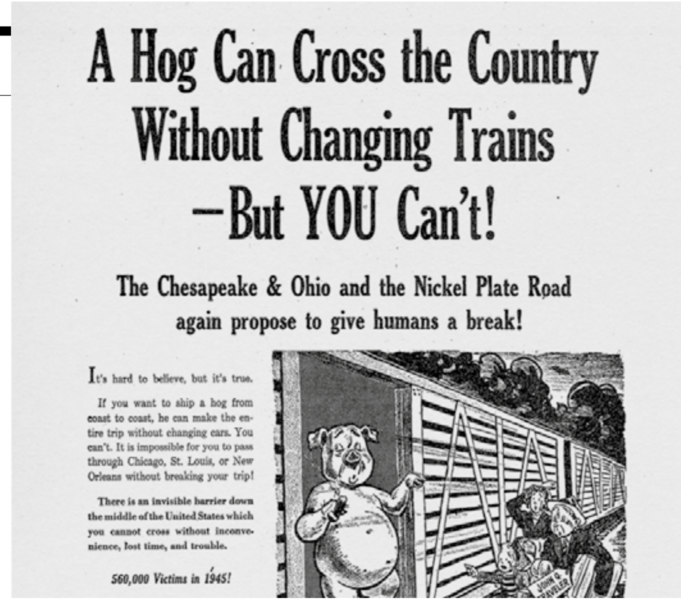
The best way of dealing with that is for institutional investors to stop outsourcing the monitoring of their investments and take it in-house. There are some companies that are not well managed. They should change management or change business strategy. I don't think we should leave that to activist hedge funds. I think that is an obligation of the major shareholders. Twenty-five institutions control most public companies. They need to step up.

How should a board deal with the potential for activism in this environment?
What these activists are trying to do is drive a wedge between the board and management. Boards need to be prepared to back the management. A board that knows what it's doing – is willing to help management tell the institutions, "We're on top of this" – they will get the support of institutions to win proxy fights. They can do what DuPont did.

Boards need to be on top of shareholder relations, to be ready to meet with institutional investors. They need to be responsive to investors and be attuned to the needs of the moment.

That means, with regard to the potential for activism, the single most important thing for a CEO is to maintain a relationship with the board of directors so the board doesn't feel pressured to seek a solution that's not in the best interests of the long-term shareholder.

It sounds like you have not slowed your advocacy?
You can say just the opposite. I feel more and more strongly about it, and I am more and more active.



An early example of shareholder activism made an impression on the young Marty Lipton while still a student at law school. Railroad tycoon Robert Young ran an advertisement criticizing the New York Central line in his fight for control of the company. It concludes, "we invite the support of the public, of railroad people and railroad investors – for this vitally needed improvement in rail transportation!"

I have one message: activism is a disaster for the economy. And unless that gets played back, we are condemning ourselves to low growth – or no growth.

What really annoys me, what I get angry about, is that the unions don't try to do something about this. Activism is the cause of these great layoffs. The Council of Institutional Investors is the breeding ground for a lot of this [activism], and that's basically a union pension fund organization. This is bad for working people, it's bad for shareholders and it's bad for the economy.

But there are times to play for peace?
You have to be realistic. Day to day, fighting these people, sometimes you just have to compromise. Sometimes it makes sense to put someone on your board, rather than go through a proxy fight. Proxy fights have a very adverse impact on a company. Sometimes it makes sense to spin something off. In many cases, the strategies urged by an activist were already under consideration. If they make sense, why not do it? I even tell my clients sometimes, let [the activist] take credit for it.

From Robert Young's proxy fight more than 60 years ago, to now, do you see a line that connects all these things we've talked about?
Businesses make mistakes. You don't have a market economy without risks and mistakes. Nobody is perfect in management. And there are people who will always take advantage of mistakes.

STEVE LIPIN is Senior Partner for Brunswick's US practice.

Hail to the campaigner-in-chief

To defend against an activist, a CEO must think like a candidate, says Brunswick's ERIC SAVITZ

Before any of the candidates in the 2016 US presidential run announced their plans, there were months, even years of preparation. Teams were assembled, focus groups formed, funding scouted and secured, slogans, digital platforms and networks mapped to ensure the candidate's message could reach as wide an audience as possible. The announcement itself merely flipped the switch on an already constructed, well-oiled machine.

That degree of planning for engagement is the best model for corporate leaders faced with a challenge from an activist investor. The battle is for the hearts and minds of voters, whether citizens or shareholders. The CEO is the incumbent; the activist is the challenger. Instead of speeches in small towns, there are stakeholder meetings; instead of candidate interviews on "Face the Nation," there are CEO spots on CNBC's "Squawk Box."

C-suites around the world are waking up to this reality as activist campaigns increase. Once derided as "corporate raiders" (think Carl Icahn, circa 1985), these high-profile investors have become downright respectable "shareholder activists" (Icahn, circa 2015) and hugely successful at forcing shifts in strategy and structure.

The pool of dedicated activist hedge funds is up 10 times since 2002 to well north of $100 billion – at least 10 hedge funds have $10 billion or more each committed to the cause. Recent targets have included Apple, DuPont, eBay, PepsiCo, Yahoo! and Microsoft. If Icahn can force change at Apple – the most respected company in the world, according to a *Barron's* survey of institutional investors – then almost no company is safe.

If you are a company leader, you are the incumbent office holder. The challenger will have new ideas, deep pockets, a media eager to cover his campaign and he will want you out. You need an ABC strategy: always be campaigning.

And make no mistake: if Icahn or Dan Loeb or Paul Singer do come calling, a broad, coordinated effort, worthy of a major political campaign will be required to fend them off. You'll need to hit the road to see investors, talk to the media, devise a social media strategy and start lobbying. You will need fact sheets, infographics and talking points. Online, offline, on the air, on Wall Street – the odds are against you, so your campaign must be intense.

Activists will begin planning their campaign as much as a year ahead of a potential vote. You will need to be equally prepared. The first time you become aware of the activist's challenge, your

ILLUSTRATIONS: OLIVER MUNDAY

opponent will already have a thick dossier in his hands – the dreaded white paper – detailing all of your company's failings (see Page 26). He may even have set up a website. If any of his findings come as a shock, you haven't done your homework.

Knowing your company's vulnerabilities isn't rocket science. Activists look for cash-laden balance sheets, underperforming fundamentals, sagging share prices and complex operations that might be better if they were split up. Take an objective look at your company's business.

Get others to do the same. It will take a crack team to manage an activist challenge. Talk to your bankers. Pick a law firm. Find a proxy solicitor. Ask them to take a hard look at your company – you might be more at risk or have more options than you realize. Don't overlook board members, CEO peers and other leaders who have been through this before and who can give you valuable advice.

The activist will get personal. Know the professional track records of your management team, and be prepared to defend them.

> **"The battle is for the hearts and minds of voters, whether citizens or shareholders"**

Evaluate your largest shareholders – know who you can count on to support the board and management team. Make sure key players know in advance what their responsibilities will be when an activist comes. Identify the dissenters and let them see that you understand their concerns.

When the time comes, you'll need to show that you are taking the activist seriously and judging his argument on its merits. Prepare your support network for the possibility of a compromise.

The goal is to be able to frame your response confidently and clearly within your company's overarching message, knowing that your campaign machine is actively supporting you, reiterating your points through pre-established channels.

Assume the activist will be equally prepared. Your ability to hold him off will depend on how well you conduct your campaign and convince investors you are right.

ERIC SAVITZ, a former journalist with *Forbes* and *Barron's*, is a Partner in Brunswick's San Francisco office.

Bumper stickers? Maybe not, but you will need a coordinated political-style strategy

LEAD FROM THE TOP
The CEO should be on point and available to the media and investors. Carl Icahn, for one, is happy to talk to reporters. He appears frequently on cable networks to press his case – to campaign. You do not want his screeds to go unanswered. The CEO's voice is the strongest.

TELL YOUR STORY BEFORE SOMEONE ELSE DOES
Have one well-honed message and stick to it. Investors have to be convinced that the activist's argument is risky. You will need to be clear, persuasive and consistent. Make sure everyone on your team is singing the same tune.

FRIENDS AND ALLIES
Political operatives show up on Sunday chat shows to make the case for candidates. You need the equivalent, only on CNBC, Bloomberg TV and Fox Business. Line up board members, analysts, academics and business partners – as long as they can act as your advocates.

BE PROACTIVE
Engage with deal reporters. Talk to them on the record when you can, and give them guidance off the record when required. Keep them in the loop.

WORK THE CROWD
Hit the road. Press the flesh. You need to get in front of your shareholders to plead your case.

USE SOUNDBITES
What's the elevator version of your stump speech? Use the fewest words to communicate your argument's most powerful points.

THINK SOCIALLY
Facebook, LinkedIn, Twitter and blog posts can help shore up support. Ask allies to use social media to reinforce your position.

Don't wait to build trust

ABE FRIEDMAN, corporate governance expert and founder of advisory firm CamberView, tells Brunswick's GEMMA HART and JAYNE ROSEFIELD how early engagement with investors can win activist fights

What are the most important elements driving the trends in activism now?

Index funds now represent the biggest category of investors on Wall Street and activists can't be successful without them. Three big factors are changing the way this community of big institutional investors behaves and they underpin the current trends in activism.

First, 30 years ago, institutional investors voted their shares in the mail room. Proxy voting was not viewed as important. At that time, index funds were only just coming into existence and investors who didn't like the way a company was operating would just sell their shares. With the dotcom bubble, the scandals at Enron and WorldCom, and then the financial crisis, clients began asking the index fund managers, "Aren't you one of the largest shareholders? Are you asking these companies the right questions? Because this is having a big impact on us." The index funds couldn't just sell the shares the way a managed fund would, so they responded by setting up corporate governance teams to do a more thoughtful job on voting and engagement.

Second, during the financial crisis, stocks tumbled, but activist funds were doing reasonably well. So a lot of money began flowing into them.

Third, companies historically didn't make an effort to get to know the people who were voting their shares – because shareholders weren't voting against companies. Meanwhile, activists were aggressively courting corporate governance teams, learning how they think and developing relationships over the course of a decade. They established an ongoing dialogue with the voters.

That created a real imbalance of influence. Now, companies are realizing that they need to get to know who these voters are and what drives them.

How do corporate governance teams compare to other investors?

The people in governance often think differently from portfolio managers or analysts. They have no interest in hearing how your quarter went or how your year went. They want to understand how you are operating the company and whether you are structured to do that in a way that protects and enhances shareholder value over the long term.

Most portfolio managers have maybe 50 or 100 stocks in their portfolio. They know those companies inside and out. Large index managers, on the other hand, will vote at about 15,000 shareholder meetings a year. With that many, they just can't know each one in the same way.

So you have to go to them and explain your business, without talking down to them. And you have to talk about the things they care about.

What do they care about?

Investor rights. Is this a board we can trust? Then in every company there are things that they'll drill in on, such as pay or strategy or governance structure. It's not that hard to build a relationship with them, but you need to know how they think. Governance teams typically can only meet with you once or twice a year, so it's important to show that you understand them. It can take years to unwind a bad impression.

PORTRAIT: PETER FIELD

Q: An activist takes 5 percent of your company's stock. How do you respond?
A: Don't wait until they have 5 percent

Index funds often vote with activists now. Has the pendulum swung too far?
In the past year or so, the trend has been toward companies settling because they don't want to deal with the distraction of a long activist battle. In the last nine months, I've been hearing a growing backlash against these settlements. Institutional investors want companies to be discerning with activist demands, not just cave in.

An activist takes 5 percent of your company's stock. How do you respond?
Don't wait until they have 5 percent. The activists have built really strong connectivity with voting shareholders. Before an activist comes, companies can level that playing field by doing the same.

The activist demands will have two sides. One will be specifics for how to improve returns – split up the company, fire the CEO, reallocate capital or whatever. That is necessary, but not sufficient. Second, the activist will always add, "By the way, you can't trust the board to do this. The only way this gets done is if I'm in the boardroom or my slate is in the boardroom."

Most companies don't take the boardroom threat seriously enough. But the reality is, if the activist doesn't get both, he doesn't win.

So the best defense is building trust with those who ultimately cast the votes?
Yes. If you can get to the people who vote your shares before the activist does, it is unequivocally better for you.

In the heat of battle, do you have any tips about framing the company message?
A small group controls 65 percent or 70 percent of the vote. So there are only 30 or 40 people who are either going to support the activists or support the company. The focus needs to be on those people. It helps to have an easy-to-grasp message, as in the infographics used in the eBay fight (see Page 13).

Index funds are a passive form of investing, designed to generate the same rate of return as an entire market index. They differ from managed funds in that they generally only buy and sell shares in order to match the weighting of the index they are tracking

Simplicity and clarity are important. Win with your message, rather than by attacking the activist.

If management responds to an activist by saying, "We looked at that, but long term it's not in our best interests," does that appeal to investors who are focused on governance?
Yes, absolutely. If you can frame the activist agenda as a short-term plan and yours as a long-term one, that's persuasive. The governance folks are "buy and hold." BlackRock, for example, manages something like $3 trillion of indexed funds. They're going to be in these stocks for 50 or 100 years. They want good, long-term, sustainable performance.

How do the companies that are winning use their management and boardroom resources?
First, they have a constant line of communication open between management and their investors, and a back channel between their investor relations and the institutional shareholder voters.

Second, the role of directors is becoming more important. For example, in the context of a pay challenge, you really need to get a member of your compensation committee in front of investors. The argument on a pay vote comes down to trust in the board. The voter should walk out of that meeting thinking, "Well, that's not exactly the way I would do it, but I trust them. Their decisions are sensible and focused on the needs of investors." Then you've won.

GEMMA HART and **JAYNE ROSEFIELD** are Partners in Brunswick's New York office, specializing in mergers and acquisitions, and shareholder activism.

ABE FRIEDMAN

Abe M. Friedman is Founder and Managing Partner of CamberView Partners. Previously he was a Managing Director at BlackRock, where he served as Global Head of Corporate Governance and Responsible Investment.

CAMBERVIEW

Founded in 2012, CamberView supports public companies dealing with complex and contested shareholder matters, specializing in corporate governance concerns. The firm is headquartered in San Francisco.

ILLUSTRATION: SEAN McCABE

Activism goes digital

Strategic use of social media such as Twitter and LinkedIn can provide a company with a powerful campaign advantage, says Brunswick's MIKE KREMPASKY

Carl Icahn loves Twitter – and you should too. On Tuesday, August 13 2013, Icahn's camp tweeted that he had taken a "large position" in Apple, calling the stock "extremely undervalued." That audacious challenge lit up the web in seconds. Within an hour, Apple's $425 billion market cap rose 4 percent, adding $17 billion. The move gave Icahn an important advantage, tilting discussions with CEO Tim Cook, board members and shareholders in his favor for weeks afterward.

But smart companies learned they can give as well as they can get. In 2014, Icahn approached eBay privately, with an interest in breaking up the company. Rather than wait for Icahn to make his move, the company went on the offensive, announcing the activist's interest on its earnings call. Tweets from executives and board members touted the advantages of keeping the company whole. The pre-emptive strike put Icahn on the defensive before he could make his ideas public. *The Wall Street Journal* ran the headline, "Did Carl Icahn Get Out-Tweeted by eBay?"

> **"Not every activist is preparing a bombshell tweet with your name on it, à la Icahn – but they could be"**

Prodded by the eBay fight, the Securities and Exchange Commission blessed the use of Twitter in a proxy fight. Digital media is now possibly the most important channel open to company leaders to gain and maintain control of a public discussion.

Of course, the best impact for any message will be its effective integration into a broader communications strategy. But the significance of digital can't be overestimated. Twitter, LinkedIn, blogs and other digital channels can help provide context, and can activate a broad base of support either for or against the company.

TWITTER HAS OFTEN been described as the new "first draft of history," a phrase used throughout the 20th century to describe professional journalism. According to one recent study, 78 percent of journalists now regularly use Twitter and other forms of social media to keep up with breaking news and more than half of those surveyed use it to find ideas and conduct research for stories.

Brunswick research shows that 77 percent of surveyed buy-side investors and sell-side analysts have investigated an issue based on information from blogs and social networks. When news breaks, a company's social media channels are often the first place that observers and stakeholders look for information.

Employees are one of the best amplifiers of company information and can provide important help in the critical moment. Workers are already using social media for work purposes and talking about work with their contacts outside of the office. Networks of friends and contacts see those employees as a legitimate source of information about your company. A 2014 report published by Indiana University noted that organizations able to guide the employee voice on social media have a clear competitive advantage.

At the same time, your workers are important stakeholders in your business. Appealing to them in the context of an activist defense can help reassure them about the company's long-term prospects. Supportive employees, in turn, will boost overall confidence in your company among investors and other stakeholders. Involving them could also help lift employee engagement generally, well into the future.

GIVEN THE IMPORTANCE of these communication channels and the high stakes in an activist fight, no company should be willing to cede the digital battlefield. The time to array your forces is long before the first digital salvo from the other side strikes home.

When considering the possibility of an activist attack, it is best to regard it as a certainty – not an if, but a when. Likewise, you don't want to roll the dice about how an activist will use social media. Not every activist is preparing a bombshell tweet with your name on it, à la Icahn – but they could be. In the end, what matters is how well prepared you and your company are to control your message in the digital sphere.

MIKE KREMPASKY, a Partner based in Brunswick's Washington, DC office, leads the Group's digital offer.

More than just a clever meme

MAP YOUR FOOTPRINT
Work toward creating a diagram of the entire range of influence of your executive leadership, including any high-profile backers of your company. Make sure you know exactly which leaders can reach which audiences.

YOUR PLAYBOOK SHOULD BE A SONG BOOK
The social media message of your leadership team must be convincing. Coordinate the timing and cadence of the content they share, not just the facts. Make it sing.

LOOK BEYOND THE BRAND
Closely monitor digital and social channels for early signs of activist investor interest and as a real-time insights tool during an engagement.

GET THE C-SUITE ON TWITTER
The voice of the executive is the most effective way to cut through the clutter and chaos of a crisis, but it is challenging to launch a digital presence from scratch during an engagement. Get your executives comfortable in the space, well before you need them.

REMEMBER THAT SOCIAL MEDIA IS HUMAN MEDIA
In social channels, it is often not enough to be clear and precise. Messages also need to be personal and approachable, even emotional. Along with confidence in your business strategy, show the passion you have for the company, its people and your vision.

eBay: out-tweeting Carl Icahn

Starting out as a corporate raider, more than 30 years and 100 campaigns ago, Carl Icahn has had one of the longest careers of today's activists.

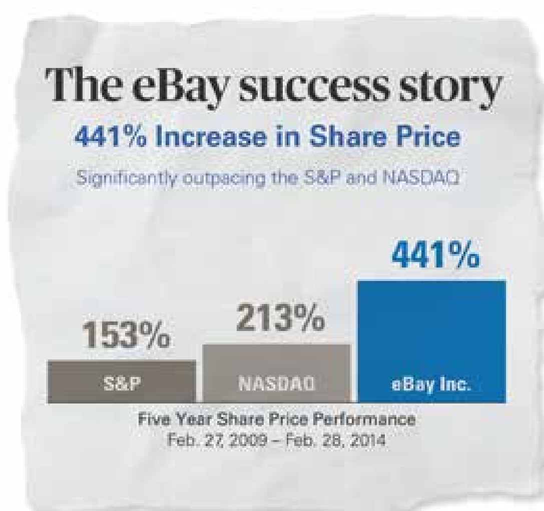
He is also one of the most social media savvy. Joining Twitter in 2013, Icahn has used it in more than 10 campaigns.

In 2014, Icahn threw down the gauntlet to eBay, proposing that it split off PayPal. eBay decided to fight fire with fire and, no stranger to digital communication, launched an aggressive, multifaceted defense that involved posts on Twitter and social media.

eBay regularly shared content directly via social channels, including company statements and infographics to highlight the strongest points of the company's story. Shown right is a detail from one such infographic, demonstrating management's record of creating long-term value for investors.

eBay's social media campaign helped propel it to a first-round victory over the Icahn-led challenge, giving the company the time to weigh its options. Ultimately, the eBay board made the decision on its own to spin off PayPal.

— **RADINA RUSSELL**



Source: eBay

Retail investors cheer on the activists

By Brunswick Insight's ROBERT MORAN and KAYLAN NORMANDEAU

When thinking about the most important type of shareholder to court during a proxy fight, who comes to mind? Your answer will be the same regardless of whichever side you are on: institutional investors.

No surprise, since they hold sway among most publicly traded companies.

But there is another important shareholder group that is finding its voice, as shown by the decisive role it played in the recent defeat of Nelson Peltz in his proxy battle with DuPont: retail investors.

There has been scant research into this group's attitude toward shareholder activism, but Brunswick Insight's inaugural survey of retail investors who are active in their personal investments makes clear that their loyalty to company management cannot be assumed. As activists continue to launch aggressive public campaigns against corporations, management may find themselves having to work hard to win the votes of these individual shareholders.

NOT ONLY ARE THE MAJORITY of retail investors paying attention to shareholder activism, but they also say they would be prepared to respond in some way to an activist investor's proposal.

More than four in five retail investors (82 percent) say they would be likely to vote on a plan put forward by an activist. Forty-four percent say they have taken some action in the past 12 months as a result of an activist's suggestions, either by voting on the proposal, by changing an investment position or by researching an activist's ideas.

Retail investors believe today's business environment is ripe for activism. More than three-quarters (77 percent) say companies are too fat and should be returning cash to shareholders, and more than half (51 percent) do not think the board is working in their favor.

Although often characterized as "pro-management," nearly three-quarters (74 percent) of retail investors say that activism adds value by pushing management to make hard decisions. Activists are seen to be constructive, rather than destructive, by a majority of investors in all age groups, genders, political affiliations and wealth levels.

It appears that retail investors are convinced they have good reason to look outside the company for help maximizing shareholder profits – a troubling indicator that bodes well for activists but could leave unprepared management in a defensive position.

ROBERT MORAN leads Brunswick Insight, the group's global public opinion research function, and is a Partner in the firm's Washington, DC office.
KAYLAN NORMANDEAU is an Associate on the Brunswick Insight team in New York.

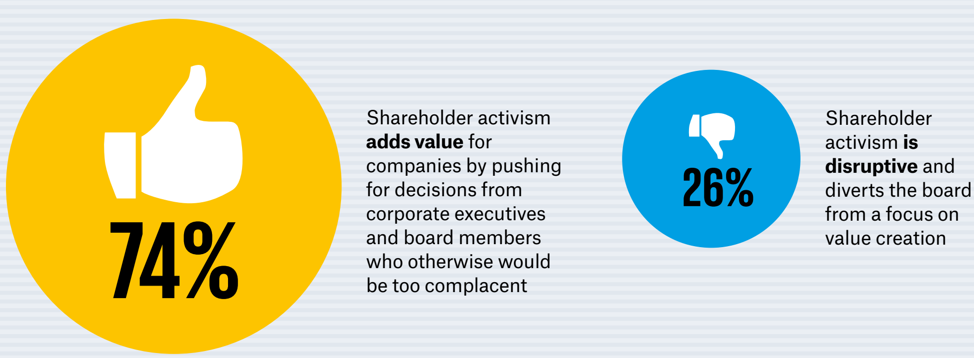
▼

While some experts believe shareholder activism is disruptive to company management and bad for the economy (see "Corporate defender," story on Page 5), retail investors tend to side with high-profile hedge fund managers such as Bill Ackman, who claim activism has the potential to add long-term value (see interview on Page 17). This finding fits with the low trust that retail investors place in management, seen elsewhere in the survey

GOOD OR BAD

DO ACTIVISTS DRIVE SHAREHOLDER VALUE?

Participants were asked which statement was closer to their opinion



BRUNSWICK | INSIGHT

Brunswick Insight provides critical issues research for market-moving decisions, and combines experienced, data-driven counsel with an emphasis on rapid research and analysis. Insight converts research into strategic advice for communications programs and campaigns

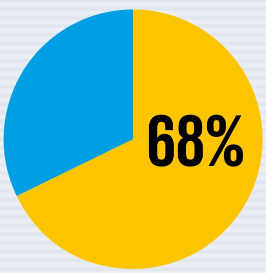
This research is based on a June 2015 survey of 801 US retail investors who actively trade stocks, mutual funds, bonds or other products, outside of retirement funds or real estate investments, and who play an active role in decision-making about their investments

AWARENESS AND BEHAVIOR

READY TO TAKE ACTION?

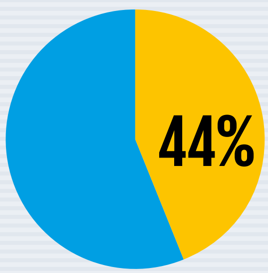
Retail investors in the US ...

... are paying attention to activism



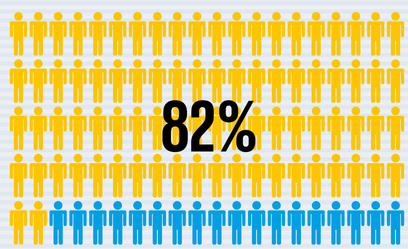
Have heard of the term "shareholder activism"

... have taken action in response to activism



Have participated in a vote, or acted in some other way as a result of an activist proposal

... are likely to vote on an activist proposal



Would participate in an activist-led shareholder vote on an issue they care about

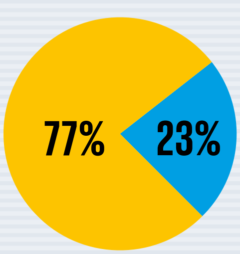
Of the 68 percent who have heard the term "shareholder activism," 11 percent are very familiar with it and could explain it in great detail; 33 percent are somewhat familiar but do not know all the specifics; and 24 percent are not too familiar with it but have heard of the term. As activism becomes more prevalent (see "Barbarians inside the gate," Page 4), we can expect retail investors' familiarity with the concept to continue to increase, along with the influence of activists

PERCEPTION

HOW MUCH DO BIG COMPANIES CARE ABOUT THE LITTLE GUY?

A majority felt corporations should be doing more to return value to investors

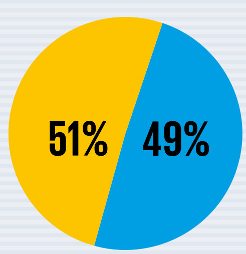
- US companies are holding more cash than ever on their balance sheets and should return more to shareholders



- US companies do not leave a lot of excessive cash on their balance sheet. Either they return profit to their shareholders, or invest for the long term

Half of those surveyed believe boards are not working in favor of retail investors

- The boards of directors of the companies in which I am invested are *not* working in my best interest

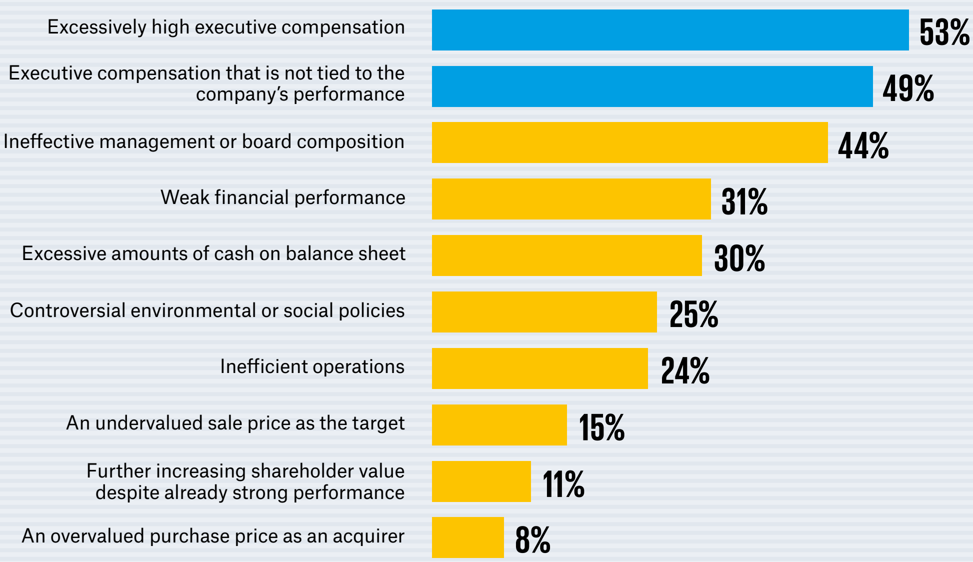


- The boards of directors of the companies in which I am invested *are* working in my best interest

Given the lack of trust in corporate boards displayed here, it is not surprising that retail investors want to push for an increased focus on returning shareholder value. Annual survey results by the University of Chicago (1972-2014) find social trust levels are declining with each generation. Social trust is defined as a belief in the honesty, integrity and reliability of others – a "faith in people." That decline could fuel a rise in discontent among retail investors, making the task of engaging them even more imperative

CRITICAL ISSUES

TOP CONCERNS THAT BUILD SUPPORT FOR ACTIVISTS

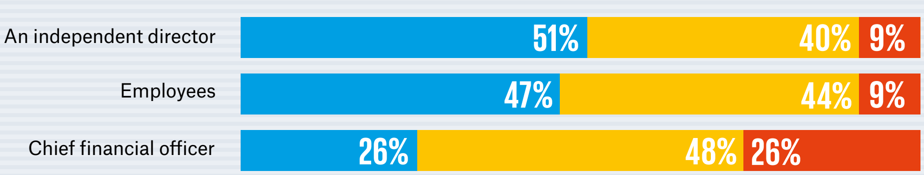


Given a list of possible reasons for an activist investor to initiate a campaign, participants were asked to pick three that they would most likely to support

Issues that make retail investors tick are not necessarily the same as those that are top-of-mind for activists. Compare the results, left, with the chart on Page 24, "Boards in the crosshairs." While executive compensation takes the No. 1 and No. 2 spots for retail investors, remuneration ranks as a low consideration for activists. Ineffective management and the make-up of boards, however, are high on the list for both retail investors and hedge fund activists

TRUSTED SOURCES

WHO ARE THE STRONGEST COMPANY AMBASSADORS?



Participants were asked to rate their trust in various company representatives.
The three shown here ranked highest, above the board of directors, CEO, COO and head of investor relations

Employees are seen here as being among a company's best ambassadors. Activating them may help win retail investor support. (Read how they can help a social media campaign in "Activism goes digital" on Page 12)

Trust
Undecided
Do not trust

MOST RELIABLE SOURCES OF INFORMATION

1. Financial news media

67%

2. A financial adviser or other investment professional

60%

3. An academic expert

33%

Participants were asked to pick three sources they would most trust when considering an activist proposal.
Others on the list included the activist; mainstream news media; friends, family members or colleagues; the company board; other company representatives; blogs or real-time subscription services; elected officials; and the company CEO

Retail investors trust financial news media most as a source of information on a shareholder campaign, more than both the activist and company representatives. This highlights the importance of maintaining an active media strategy in all channels, led by top company representatives (see "Hail to the campaigner-in-chief"on Page 8)

ALL CHARTS: BRUNSWICK INSIGHT

Inside the mind of an activist

High-profile hedge fund manager BILL ACKMAN disrupts companies, demanding they perform better. The Pershing Square founder says boards should listen, not just fold, when an activist shows up. Interview by Brunswick's STEVE LIPIN

Bill Ackman launched Pershing Square Capital Management in 2003, in an era when shareholder activists were a rarity. He has since become one of the most influential, vocal and successful activists and his firm ranks among the top hedge funds in the world. According to *Forbes,* in 2014 Pershing Square managed some $18 billion and its principal hedge fund returned 37.2 percent for its investors.

Ackman made headlines recently when Pershing Square disclosed it had taken a $5.5 billion stake in food and beverage conglomerate Mondelez, makers of Cadbury chocolates, Ritz crackers and Oreo cookies. The position is one of the biggest ever held by an activist, and amounts to 7.5 percent of the company.

PORTRAIT: PETER FIELD

The day after the Mondelez announcement, Ackman spoke to the *Brunswick Review* about the role of activism, the benefits of the shareholder voice in the boardroom, why boards shouldn't automatically give in to an activist's demands, and what he wants boards and CEOs to know about his firm's intentions.

Why has activism become so prevalent across corporate America?

Activism is something that takes an entrepreneur to execute, and the amount of capital controlled by entrepreneurial activists has grown significantly. It's been a very successful strategy, and that has attracted capital and more investors.

If you go back 100 years, Andrew Carnegie was a shareholder activist. After he sold his steel businesses to J.P. Morgan to create US Steel he continued to play a role in how the company was run. Morgan is another example. Back then, he was a merchant banker, but if he were operating today people would think he was a shareholder activist. He took large stakes and played a meaningful role in management.

So where are we now?

Capital markets have been democratized. The development of mutual funds and the growth of indexing over the past 30 years have made shareholders more passive.

At the same time, boards have become incredibly knowledgeable about shareholder activism. There has been an evolution in their thinking. I think boards are recognizing that the

BILL ACKMAN

William Ackman is the CEO and Portfolio Manager of Pershing Square Capital Management. He previously co-founded Gotham Partners Management, an investment adviser that managed public and private equity hedge fund portfolios.

PERSHING SQUARE CAPITAL MANAGEMENT

Founded in 2003, Pershing Square is a hedge fund for private investment funds with $18 billion under management in 2014. With offices in New York City, the company takes its name from Pershing Square, a small plaza across from Grand Central Station.

more traditional passive owners are willing to support an active shareholder. The BlackRocks and Vanguards will support an activist in a high-profile big company – that, in and of itself, changes the landscape. Capital tends to flow into strategies that generate above-market returns, and it feeds on itself.

How should a board react when they get a letter from an activist?

They should listen. If a good idea comes in from the outside, it's free advice. They should take it seriously and consider it. Activists are just shareholders at the end of the day.

If a shareholder says, "Look, you have dramatically underperformed for a period of time, your competition has twice the margins you have, and we think the issue is a management issue," then a company has to take that very seriously and study it with management.

If it's a good idea, they should implement it. If it's an idea that destroys value, they should go back to the shareholder activist and explain why it's not in the best interests of the corporation, and they should do it with particularity. That is basically their call.

Boards should not just fold when a shareholder activist shows up. They should carefully analyze what's been proposed. If it makes sense, they should do it. If it doesn't make sense they shouldn't do it. If some version of what has been proposed makes sense, they should do *that*.

Compared to when you started, is it fair to say that boards are listening more, and are engaging with shareholder activists?

Yes, I think boards are much more open to ideas from the outside. I also think the relationship between the board and the CEO has changed dramatically, in particular at bigger companies.

It used to be that at a company with a $10 billion market capitalization, the CEO and the board were very much removed from the shareholders. The board would always be re-elected each year regardless of the performance of the company, with a very high percentage of the vote. The only way to vote against was more of a protest vote, a "withhold" vote.

What has changed is that there have been proxy contests with companies of very significant scale. The directors are at risk of embarrassment of being thrown off the board. It's not a good thing for the résumé of a professional director who wants to spend the rest of his or her career sitting on three or four boards to get thrown off a board in a proxy contest. That fear of being thrown off by your own shareholders makes the board much more unwilling to roll over when the CEO says do something. Their own reputations are at risk. This was not the case 10 or 20 years ago.

So boards have less patience with CEOs? It's more personal for board members?

It used to be that their only fear was liability from malfeasance, an accounting scandal, fraud, being on the board of an Enron, that sort of thing. If the CEO wasn't crooked, it could be a cushy place for 10 to 15 years: go to board meetings, board dinners, and hang out with interesting people and talk about interesting things. But no one would ever second-guess the decision a board made or a director made.

Now, there's a lot of scrutiny over acquisitions, compensation and business performance – in a way that I think is very healthy for capital markets and corporate America. It used to be, if you were the CEO of a $10 billion or $20 billion company, that was pretty much your job for the rest of your career. Today the standards are higher. Mediocrity is not something shareholders tolerate.

> "The way some companies defend against an activist is destructive to shareholder value"

Is "getting ahead" of the activist a positive result of this trend?

It depends what they do. The way some companies defend against an activist is destructive to shareholder value and reduces the company's flexibility. That can be a reflexive reaction, but for many companies that's not the right thing to do. Boards and CEOs will say, "Hey, the way we'll protect against an activist is to launch a big buyback program." It can be very disruptive to long-term business investment and even short-term shareholder value if they're purchasing stock above intrinsic value. That's a negative consequence, not a positive impact.

You saw McDonald's replace the CEO after a two-year tenure. Other than for malfeasance, I have not seen that happen at a big company for business performance. The company was mentioned periodically in *The Wall Street Journal* as being ripe for activism for poor performance, and the board took it upon itself to replace the CEO after a relatively short tenure. Usually the CEO gets at least four or five years. Two years is a shockingly short period of time unless the business performance is clearly poor but, even then, it never happens at big companies.

At McDonald's, the board realized they were vulnerable to a shareholder activist coming in, so that was a pre-emptive move to prevent that.

What's your view on whether the role of chairman and CEO should be separate?
I think generally that separation is a good thing, though not always. And it depends on the people. There are examples of well-run companies, such as Berkshire Hathaway and JPMorgan, where prominently the chairman and CEO are one person.

We're a shareholder of Air Products & Chemicals, which has combined the positions. The company's CEO Seifi Ghasemi is doing a superb job, and the board concluded that there was no better person to be chairman. We are quite comfortable with that.

But I've also seen that when someone becomes a little too powerful in the boardroom, it can make the directors reluctant to challenge the CEO. When there's separation, it's more likely that there is a power in the boardroom that other members could speak to offline.

That could happen with a lead director, but there is something about the implied power of the chairman title that helps create more balance.

When a CEO gets a call or letter from you, what would you want them to know?
Number one, we would never propose anything unless we believe it is in the long-term best interests of the company, period. We take very large stakes in companies and we tend to own them for years. In almost all of the 32-odd activist situations we've been involved in over 11 years, the stock trades at a meaningfully higher price today than even after we exited.

There were only two exceptions, JCPenney and Borders. To me, that is the best measure of whether we are creating sustainable value or not. So if a CEO receives a call, they should know that whatever we propose is what we believe is in the best long-term interests of the business.

Q: How should a board react when they get a letter from an activist?

A: They should listen. If a good idea comes in from the outside, it's free advice

Second, they should know that we're going to do what we say we're going to do. If we say we're going to keep something confidential, we're going to keep it confidential. If we feel strongly about something, if we think there needs to be a change in management, if we don't get that outcome, we will run a proxy contest for a meaningful number of directors.

Canadian Pacific is a good example. I don't think the chairman of the board believed me. I wrote him an email outlining precisely what we were going to do. It wasn't meant to be a threat, but to say, "As an owner of the business, here are the steps we will take."

That doesn't guarantee that what we propose is right. If management comes forward and tells us we're wrong, all we want is direct feedback. And we want a chance to have a serious discussion.

And then, assuming you gain seats on the board, what can they expect?
If we are on the board, we will be an interested and involved director. We won't get involved in the day-to-day operations – that is the CEO's job. We will be very interested in the overall performance of the company, compensation of employees and management, and I think people will find it a positive experience working with us. Having a large shareholder where management and other directors can review significant strategic decisions in a private setting can be a very helpful thing.

If they're going to do something to cause a short-term negative impact on earnings over the next year, but which will create a lot of long-term value, having a large investor backing the transaction and sitting on the board can provide a big comfort factor.

STEVE LIPIN is Senior Partner for Brunswick's US practice.

US-style activism casts a long shadow

While slow to follow the US lead, international markets are taking notice

SHAREHOLDER ACTIVISM remains largely a US phenomenon, where it is associated with big hedge funds and larger-than-life personalities calling for stock buybacks or increased dividends. While these high-profile campaigns can lift share value, they are often criticized as focusing heavily on short-term financial gains to the detriment of long-term interests and the broader needs of all stakeholders, including employees, customers and the surrounding community.

Elsewhere in the world, however, "shareholder activism" can mean something very different and workers and the community are put first as pressures are brought to bear on companies to change corporate or social behavior. Concerns for the environment, human rights and politics have been effectively aired through such activist shareholder campaigns.

Investor campaigns for social change in the US are common but are overshadowed by the big money at play in the hedge-fund variety. Meanwhile, the US experience of shareholder activism, while it has so far failed to take root in most other countries, remains a growing influence, and is helping reshape corporate structure and financial markets across the globe.

Time to brace for activist surge

By **ANDREW GARFIELD** and **KATIE IOANILLI**

A WAVE OF SUCCESSFUL shareholder activism has long been anticipated in Europe, modeled on the US experience. But differences in rules and culture keep activism muted, even as campaigns in the US have soared. High-profile US-based activists such as Thomas Sandell, Dan Loeb and Carl Icahn have all had tilts at well-known European companies over the past two years, but so far these have largely fallen flat. Ego-driven contests just don't have the same sex appeal as they do in the US.

The result is that some management teams have a false sense of confidence, to the point of complacency, when they should really be bracing for an activist challenge.

Europe, of course, is not one homogenous place, but a patchwork of differing jurisdictions, corporate cultures and legal frameworks. From the US perspective, the UK is often seen as an entry point to Europe: it shares the same language, a familiar legal system and a large number of quoted companies, many already well known to US investors. But those similarities can be deceptive. UK corporate governance is generally good, and in many respects even more evolved than the US. Companies enjoy healthy dialogue with shareholders and, with UK governance rules mandating independent chairmen and a senior independent director as points of contact for disgruntled shareholders, noisy US-style activism is seen as a last resort.

In countries such as France or Italy, minority shareholders are more often expected to know their place. While companies may appear to be susceptible, they can generally rely on pliant domestic shareholders and strong support from local sympathizers in the media, politics and labor unions.

Homegrown activists, such as Stockholm-based Cevian, advocate a more genteel style, relying on private talks with corporate management, which they say work better in Europe than confrontational media campaigns. In fact, European companies may have more to fear from growing agitation within their traditional shareholder base, than from big US activist investors. Blue-chip corporations such as Shell, UBS and Deutsche Bank have had to deal with a rising tide of protest votes over governance issues such as boardroom pay.

However, the opportunities for activism are just as present in the UK and continental Europe as in the US. Activists are drawn to companies with, among other things, significant underperformance compared with peers, underutilized cash on the balance sheet, insufficient focus on returns and unwieldy portfolios – all factors that are just as common among European companies.

In 2015, Scotland-based investment company Alliance Trust bowed to pressure to accept activist Elliott Advisors' board nominations after a loud public campaign highlighted serial underperformance by the management team led by the seemingly unimpeachable CEO Katherine Garrett-Cox, a Veuve Clicquot Business Woman Award winner. Also in 2015, the France-based global media and telecoms giant Vivendi averted a hostile shareholder meeting only by agreeing with US activist investor Peter Schoenfeld to review strategy.

Challenges from US or international hedge funds are only likely to increase, however slowly. In such a landscape, complacency among European companies appears misplaced. Instead they would be wise to gather intelligence about their shareholders and assess their vulnerability.

ANDREW GARFIELD is a Brunswick Partner and **KATIE IOANILLI** a Director. Both are based in the London office.

ILLUSTRATIONS: MICHAEL BRANDON MYERS

Cue for more engagement

By TIM PAYNE

UNTIL RECENTLY, a combination of less mature capital markets and controlling positions in companies held by families have made Asia an unattractive place for US-style hedge fund activists to create returns. Japan in particular has seen several high-profile US-style campaigns easily defeated, as a result of differences in corporate culture and governance structures.

However, recent moves by mainstream funds point to a changing landscape, where activists in Asia are increasingly portrayed as shareholder champions. Elliott Management's 2015 campaign against Samsung, protesting the sale of its construction unit, was audacious, aiming right into the belly of the Korean business establishment. While the final vote sided with management, the activist took 30 percent of the tally.

Historically, activism in Asia has taken three primary forms. In the first, dissident management fights for control of an asset. The most extreme example is Chinese electrical appliance retailer Gome's former chairman fighting a proxy contest from prison in an attempt to unseat the incumbent management.

In the second, small minorities of otherwise unconnected shareholders band together to block actions by the board. Hedge funds have played a role in these situations, helping drive outcomes in favor of minority shareholders.

The third form, short activism, is sometimes anonymous, but includes Muddy Waters' high-profile attacks on companies such as Sino-Forest and Olam. US companies have also been attacked by short-sellers over their business practices in China, such as hedge funds that alleged Lumber Liquidators lied about formaldehyde levels in China-made flooring.

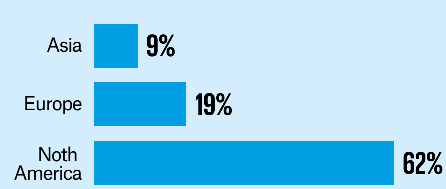
Such campaigns against Asian companies exploit a deep anxiety over information arbitrage. Foreign shareholders often have a shallow understanding of companies' business practices. Transparency levels can also be low, helping fuel fears of unknown monsters swimming beneath the surface of a company's results.

While activism in Asia does not yet compare to the US type that aims to drive significant structural change, companies long perceived as secure are becoming vulnerable, and complacency is dangerous. Asian companies need to be ready to fight an attack on their track record and values. The governance of family businesses, in Asia in particular, is less likely to be trusted and understood by the wider market. Boards need to be ready to show that they are aligned to the interests of all shareholders, instead of running businesses for themselves. To see off an activist threat, boards and key shareholders will need to engage investors more directly and clearly than they have had to do in the past.

TIM PAYNE is a Senior Partner and Head of Brunswick's Asian business.

Impact assessment

Global dealmakers were asked to rank the impact of various factors on M&A in 2015. In the survey, shareholder activism ranked far lower in Asia and Europe than in the US



Source: Brunswick Insight

Abe's reforms open a door

By ALICIA OGAWA, COLUMBIA UNIVERSITY

BUILDING ON HIS 2012 ELECTION PROMISE to revitalize Japan, Prime Minister Shinzo Abe launched a series of reforms that includes significant changes in corporate governance, potentially permitting greater pressure from shareholders. With a new Corporate Governance Code, Stewardship Code (aimed at investors), and amendments to the Company Act, Abe hopes to force market discipline on company management. By themselves these measures won't bring a rapid rise in US-style activist shareholder campaigns, but they are a first step.

The new rules do help unlock an important door for foreign investors, who now own more than 30 percent of all listed shares in Japan. Foreign activists are very likely to succeed in prying higher dividends and share buybacks out of cash-rich Japanese companies. Dan Loeb's Third Point has had some much-noticed success already with challenges to Sony and robot-maker Fanuc. However, activists' ability to promote long-term change in corporate restructuring and board function will be very weak for a long time to come.

Popular practices that helped drive Japan's economic boom in the 1970s and '80s are now regarded by Abe and others to be a cause of the country's sclerosis. These include the commitment to lifetime employment, limiting ownership of shares to passive and friendly investors, and preventing outsiders from joining corporate boards.

The typical Japanese company is a tightly knit family, favoring the stakeholders most directly involved in the business – particularly customers and workers. A 2013 survey by the Ministry of Economy, Trade and Industry ranked management's top three stakeholder priorities. Ninety percent put customers first, while only 8 percent identified foreign investors as a priority.

Abe's new rules may help change that culture, but adoption will be slow and companies may opt out of compliance if they can offer a reasonable justification. One change in particular seeks to move companies toward a US-style corporate structure by requiring that outside directors serve on auditing, nominating and compensation committees. Traditionally, Japanese companies strongly favor insider control. An amendment to the Company Act offers a compromise that puts outside directors on a single audit committee with supervisory functions that include nominations and compensation.

Corporate governance is being hailed as Abe's signature accomplishment. Getting such a contentious item on the political agenda at all is significant, a signal of the potential for change. Given entrenched resistance however, true structural reform will be a difficult, painful and slow process.

ALICIA OGAWA is a consultant to international investment funds and a senior adviser to the Center on Japanese Economy and Business at Columbia Business School. She was previously Managing Director at Lehman Brothers in charge of Global Equity Research and Director of Research at Nikko Salomon Smith Barney.

Minority stakes gain a new voice

By AZHAR KHAN

TOUGHER REGULATIONS and a trend toward better governance are giving rise to a new wave of activism in India by small, large and even foreign shareholders. Companies in India are typically owned by insiders who control all decisions in cooperation with management, often conflicting with the interests of other shareholders. However, some developments have given minority investors a powerful voice.

First, tougher rules set in 2010 by India's Securities and Exchange Board require mutual funds to disclose how they vote on shareholder resolutions. This accountability has led to voting by domestic institutions doubling in two years. Institutional funds even forced Maruti Suzuki, India's largest carmaker, to rewrite a deal for a new plant in western India. Second, a requirement that companies offer electronic ballots has greatly improved access by India's shareholders and the reliability of votes. Third, a rise in proxy advisory firms gives shareholders access to rigorous analysis to use as ammunition. Finally, as of 2013, majority shareholders are prohibited from voting where they have a potential conflict of interest. This measure strikes at the heart of owner-management impunity and gives minority shareholders a decisive say.

These elements came together when UK brewer Diageo acquired a controlling stake in India's United Spirits in 2014. Minority shareholders, aided by proxy firm IiAS, were able to force management to disclose important financial details.

Foreign activists have also begun taking a close look at India. The Children's Investment Fund took on Coal India, a state-owned miner, in 2012. The UK-based activist hedge fund established a large position in the monopoly and launched a bold demand for changes, including a hike in coal prices. The campaign ultimately failed, but as a challenge to the status quo, it set a precedent that will be difficult to ignore.

AZHAR KHAN is a Director in Brunswick's Mumbai office.

Investors press for social change

By CAROL ROOS and TIMOTHY SCHULTZ

WHILE SOUTH AFRICA doesn't have US-style activists yet, its culture of corporate transparency has encouraged a domestic form of activism, emphasizing social transformation.

South Africa was an early adopter of a set of world-class "best practice" principles for corporate governance called the King Reports. These include increases in reporting transparency that are required for a listing on the Johannesburg Stock Exchange.

To help reverse the dire socio-economic effects of apartheid, the government created the Black Economic Empowerment program, targeting areas such as black management control and ownership, and support for smaller black business.

Controlling assets of more than R1.6 trillion ($115 billion) – comprising mostly government employee pension funds – South Africa's Public Investment Corporation is Africa's largest fund manager and engages in a form of socio-economic impact activism. While independent, the PIC has what it calls a "dual mandate, to generate returns on behalf of clients and to contribute to the developmental goals of South Africa."

The PIC has supported a number of state policies, including blocking Chile's CFR Pharmaceuticals' bid for local healthcare company Adcock Ingram, to keep control in South Africa. The PIC also supports income equality by voting against excessive pay, and has pressed for more black directors at companies such as fuel maker Sasol and industrial services supplier Barloworld.

As shareholder activism continues to grow in South Africa, it is likely that this intersection of politics and business will remain critically important, and the power of investors to act as agents of social policy will increase.

CAROL ROOS and **TIMOTHY SCHULTZ** are Directors in Brunswick's Johannesburg office.

PORTRAIT: PETER FIELD

Staying ahead of the activists

MICHELLE EDKINS, Head of Corporate Governance at BlackRock, the world's largest money manager, tells Brunswick's MONIKA DRISCOLL that activism has upped everyone's game

Can you describe BlackRock's corporate governance philosophy?
Most of our clients are investing to meet their long-term financial goals, such as retirement income. Many are in indexed portfolios so they are, in effect, locked-in shareholders. We use our voice on their behalf to ensure companies are being well led and well managed. We don't see our corporate governance guidelines as a set of rules that has to be complied with, but more as a benchmark against which we can assess the quality of leadership demonstrated by the board and the quality of management's execution.

How does that affect your views on shareholder activism?
We try to couch all our conversations around corporate governance. In activist situations, we use that as the framework to assess what the activist is proposing, as well as the company's track record and counter-arguments.

Are you less concerned about the economics of these public companies?
No, we're absolutely concerned with the economics, but over time. With some shareholder activist campaigns, there will be a share price reaction in the near term if a company does what an activist is asking, but we're concerned if that sets the company up to be weaker in the future.

How is the investment industry changing in response to growing activism?
In the past five years, many major institutional investors have expanded their teams, in large part because there is greater client interest in how we engage companies, particularly following the financial crisis. Corporate governance teams are more willing to engage with activists because we want to make informed voting decisions, which means understanding the position of both the activist and the company. Activists typically choose companies where change appears to be needed – where there's a consensus that something is not working. As a result, activists often get a pretty good hearing from mainstream investors. The activists have also become more sensitive to

MICHELLE EDKINS

Michelle Edkins is a Managing Director at BlackRock and Global Head of its Corporate Governance and Responsible Investment team, comprising 22 specialists based in five regions internationally. She also serves on the firm's Human Capital and Government Relations Steering Committees.

BLACKROCK

Founded in 1988, BlackRock is a publicly owned multinational investment management firm, headquartered in New York City. Clients include private individuals, corporations, foundations, charities, public institutions and pension plans.

the concerns of institutional investors and are positioning their proposals in a more long-term context. In short, everyone has upped their game on the governance and engagement front.

Do you think more companies are listening to investor concerns?
Each year it seems that more companies seek engagement with us. Activism and "say on pay" are two drivers. Companies also seem to value the insights they gain from talking to shareholders directly, especially if investors have concerns about performance or governance.

How should companies engage with large institutional investors like BlackRock?
More companies now understand that they must build relationships with their long-term, long-only investors. Boards should know who to call and how to have that conversation before stressful circumstances arise. We don't want to have one-on-ones with every board member in corporate America, but it is worthwhile for a company to set out a five-year engagement strategy to ensure that its lead independent director and chairs of key committees have met the top 50 shareholders. That way, the communication channel is open when the company needs to speak with investors if there is a crisis, or an activist shows up as one of the largest shareholders.

How much time does BlackRock spend engaged with activists?
Activists obviously have a lot vested in these individual situations, but it's important to be mindful of the fact that from our perspective, each company is just one of many we're invested in on behalf of our clients. Activists often want us to sit down for a whole day with them to walk through the detailed analysis they've done on a company, but our priorities have to be different. That said, in sensitive situations, or if a campaign leads to a proxy vote, we will devote the time to understand the position of the activist and the company involved.

How often does BlackRock support activists?
Only a small subset of activist situations come to a vote. In about half of those that do, we support the activist, but we very seldom support the whole slate that an activist puts forward. We might vote in favor of one or two of their candidate nominees, usually because the company has not been responsive, does not seem to understand shareholders' concerns, or focuses on belittling the activist rather than providing a credible counter-argument.

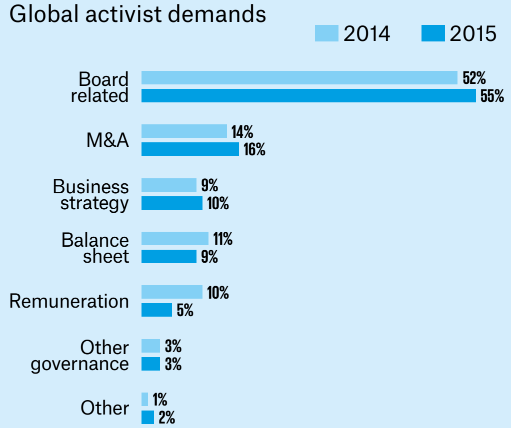
> **"I find the public nature of activist campaigns in the US frustrating, because one side is always presented as the winner and the other as the loser"**

How is corporate governance in the US different from Europe and other regions, and does that have an impact on the amount of activism in those countries?
One of the most significant differences between the US and other markets is that majority voting on directors is established as a right in corporate law nearly everywhere else. That's an accountability mechanism. Directors can be voted off the board if they are unresponsive to shareholders. That leads to more frequent and more productive dialogues.

So there is a history of closer engagement between investors and boards outside the US?
Yes. If you look at the voting statistics, you'll see that shareholders haven't voted many directors off the boards of European or Australian companies, for example. They don't have to. They're able to have more engaged conversations with the board and express concerns, and the directors know they will be held accountable.

Furthermore, business communities are much more concentrated in other markets than they are in the US. As a result, investors in London, say, or Sydney, are regularly mixing with company

Boards in the crosshairs
Global activist demands



First-half data / Source: Activist Insight representatives, including board members, at industry events. So, there is a significant level of informal engagement, not specific to a company situation, which helps establish relationships. It wasn't that long ago in the US that it was considered highly controversial to put investors and directors in the same room.

Is the behind-the-scenes engagement that tends to happen in Europe a good or bad thing?
I find the public nature of activist campaigns in the US frustrating, because one side is always presented as the winner and the other as the loser. These situations are more nuanced than that. To say one side won or lost is unhelpful to the company, to the shareholders and to the reputation of activism.

A lot of activists raise valid concerns but they're not always right. If activism was done privately rather than through the media, the appropriate change – though it might take longer – would come about and would be far less disruptive to the company. In Europe, shareholders have greater access to companies and it is easier for them to communicate with each other, so change can happen in a less publicly confrontational manner.

How do you see the corporate governance landscape continuing to change?
There is more substantive engagement now between company management, boards and shareholders. That's a positive sign and activists have been a catalyst for that. If boards and management listen to shareholder concerns privately, they may find remedies before an activist targets them.

In one-on-one meetings with companies, mainstream investors are often signaling concerns in the way they ask a question or focus on one thing over another. Companies are often not very attuned to those messages. Being more aware of that and listening for what's not being said could help companies respond before issues escalate.

In addition, in situations where boards were aware of the issues but weren't able to take action quickly, having better communication and a stronger relationship on the long-term side – on the governance side – helps earn investor support in the near term.

Q: How do you see the corporate governance landscape continuing to change?

A: If boards and management listen to shareholder concerns privately, they may find remedies before an activist targets them

Are there other aspects of shareholder engagement that companies should consider?
Companies should use their regular communication channels – including quarterly earnings calls – to better get across the message about how they are creating long-term value. It starts with the proxy statement, but should be reflected in website content, supplemental materials, letters from the board and other presentations.

In addition, companies need to get much better at talking about how they're managing their environmental and social impacts. These can be financially material issues and need to be handled well, as they indicate management quality. If management is unconsciously risking the company's reputation, what else is not being well managed? It could be a signal.

Finally, what is the role of a company's reputation in an activist campaign?
A company's reputation can take a beating during an activist campaign. However, being under the spotlight of an activist could even be an opportunity to articulate the company's strengths. Boards and management should have the courage of their convictions. Negotiation is right when the activist's proposals would enhance the company's long-term success. But management shouldn't capitulate in the hope that it will make the activist go away. That's not good for the company's reputation or for the reputations of the individuals involved.

MONIKA DRISCOLL is a Partner in Brunswick's New York office. Formerly an analyst, she focuses on shareholder activism defense, and mergers and acquisitions. Additional reporting by **EMILY LEVIN**, an Associate now based in the firm's Johannesburg office.

Paging the boardroom

CEOs and boards are right to fear losing control of the narrative to the much-feared white paper, says Brunswick's BILL LAUNDER

Am I going to be white papered? For a CEO running a public company, it's the ultimate corporate slapdown. The acerbic, unwieldy "white paper" is a favored weapon in the shareholder activist's arsenal. The activist may know much less about your company than you do, but has suddenly grabbed the spotlight with a dense 100-slide-plus PowerPoint presentation designed to show that he has done his homework and is ready for a fight.

Equal parts manifesto, financial analysis and snark, the white paper frames the narrative around the company the way the activist sees it. The document is designed to put corporate boards immediately on the defensive.

The typical activist white paper isn't light reading but an outside audience might find bits of it entertaining. Mostly it will be heavy on detail, impressive by its sheer volume.

Sometimes, the points raised will be less than obvious to all but the most well-versed readers. Unused patents with significant auction value gathering dust in your corporate portfolio? The possibility of re-incorporating as a real estate investment trust for tax savings? Both are real-life issues raised by activists that had nothing to do with the likes of underperforming business units or executives who failed to pass muster.

The financial media loves a good white paper, both for its insights into the details of the activist's challenge and as a handy source for quippable quotes. Its contents will be dissected and reexamined at every step throughout the campaign. Seemingly trivial points can rapidly turn into soundbites that dart across social media and news outlets. They are memorable and they stick.

Dan Loeb's hedge fund Third Point accused the management at Sotheby's of being "asleep at the switch" in a much-quoted excerpt from the fund's white paper on the auction house. Jeff Smith of Starboard Value presented a nearly 300-page white paper on Darden Restaurants detailing waste at operations such as the Olive Garden chain, including servers bringing diners too many breadsticks, as well as a gripe about the absence of salt in its pasta water (to increase the longevity of its pans).

Topping them all was Bill Ackman's 342-slide lecture to investors on Herbalife, an epic exposé that portrayed the health products company as a pyramid scheme. The presentation fueled a multi-year fight involving some of activism's biggest names and helped shatter the share price.

What does this mean for companies and boards worrying about being blindsided by an activist attack? Bottom line, get your narrative out there first before an activist takes the white paper route and beats you to it.

BILL LAUNDER is an Associate in Brunswick's New York office.

"We need to talk. Here – it's all in this 342-slide PowerPoint."

CARTOON: KAAMRAN HAFEEZ

Brunswick Group offices

ABU DHABI
Office 506
Park Rotana Office Complex
Twofour54
PO Box 77800
Abu Dhabi
United Arab Emirates
T: +971 2 234 4600
uaeoffice@brunswickgroup.com

BEIJING
2605 Twin Towers (East)
B12 Jianguomenwai Avenue
Beijing, 100022
People's Republic of China
T: +86 10 5960 8600
F: +86 10 6566 3856
beijingoffice@brunswickgroup.com

BERLIN
Taubenstraße 20-22
10117 Berlin
Germany
T: +49 30 2067 3360
F: +49 30 2067 3366
berlinoffice@brunswickgroup.com

BRUSSELS
27 Avenue des Arts
1040 Brussels
Belgium
T: +32 2 235 6510
F: +32 2 235 6522
brusselsoffice@brunswickgroup.com

DALLAS
200 Crescent Court
Suite 225
Dallas, TX 75201
USA
T: +1 214 254 3790
F: +1 214 254 3791
dallasoffice@brunswickgroup.com

DUBAI
Level 5
Gate Village Building 10
PO Box 506691
Dubai International
Financial Centre
Dubai
United Arab Emirates
T: +971 4 446 6270
F: +971 4 436 4160
uaeoffice@brunswickgroup.com

FRANKFURT
Thurn-und-Taxis-Platz 6
60313 Frankfurt am Main
Germany
T: +49 69 2400 5510
F: +49 69 2400 5555
frankfurtoffice@brunswickgroup.com

HONG KONG
12/F Dina House
11 Duddell Street, Central
Hong Kong SAR
T: +852 3512 5000
F: +852 2259 9008
hongkongoffice@brunswickgroup.com

JOHANNESBURG
23 Fricker Road
Illovo Boulevard, Illovo
Johannesburg
South Africa
T: +27 11 502 7300
F: +27 11 268 5747
johannesburgoffice@brunswickgroup.co.za

LONDON
16 Lincoln's Inn Fields
London WC2A 3ED
United Kingdom
T: +44 20 7404 5959
F: +44 20 7831 2823
londonoffice@brunswickgroup.com

MILAN
Via Solferino, 7
20121 Milan
Italy
T: +39 02 9288 6200
F: +39 02 9288 6214
milanoffice@brunswickgroup.com

MUMBAI
The Capital
814, 8th Floor
C-70, G Block, Bandra Kurla Complex
Bandra East
Mumbai 400 051
Maharashtra
India
T: +91 916 788 3290
mumbaioffice@brunswickgroup.com

MUNICH
Widenmayerstraße 16
80538 Munich
Germany
T: +49 89 809 90 250
F: +49 89 809 90 2555
munichoffice@brunswickgroup.com

NEW YORK
245 Park Avenue
14th Floor
New York, NY 10167
USA
T: +1 212 333 3810
F: +1 212 333 3811
newyorkoffice@brunswickgroup.com

PARIS
10 Boulevard Haussmann
75009 Paris
France
T: +33 1 53 96 83 83
F: +33 1 53 96 83 96
parisoffice@brunswickgroup.com

ROME
Piazza del Popolo, 18
00187 Rome
Italy
T: +39 06 36712806
F: +39 348 7098590
romeoffice@brunswickgroup.com

SAN FRANCISCO
One Bush Street
Suite 1400
San Francisco, CA 94104
USA
T: +1 415 671 7676
F: +1 415 671 7677
sanfranciscooffice@brunswickgroup.com

SÃO PAULO
Avenida Dr. Cardoso de Melo
1.340 - Sala 42
Vila Olimpia
São Paulo SP
Brasil 04548-004
T: +55 11 3076 7620
saopaulooffice@brunswickgroup.com

SHANGHAI
Room 2907,
United Plaza
1468 Nan Jing Road West
Jing'an District
Shanghai 200040
People's Republic of China
T: +86 21 6039 6388
shanghaioffice@brunswickgroup.com

SINGAPORE
6 Battery Road
#15-05 Singapore 049909
T: +65 6426 8188
F: +65 6426 8199
singaporeoffice@brunswickgroup.com

STOCKHOLM
Fourth Floor
Birger Jarlsgatan 15
111 45 Stockholm
Sweden
T: +46 8 410 32 180
F: +46 8 611 00 56
stockholmoffice@brunswickgroup.com

VIENNA
Concordia Haus
Bankgasse 8
1010 Vienna
Austria
T: +43 1 907 65 10
F: +43 1 907 65 10 40
viennaoffice@brunswickgroup.com

WASHINGTON, DC
1099 New York Avenue, NW
Suite 300
Washington, DC 20001
USA
T: +1 202 393 7337
F: +1 202 898 1588
washingtonoffice@brunswickgroup.com

Brunswick Group companies

BRUNSWICK ARTS
16 Lincoln's Inn Fields
London WC2A 3ED
United Kingdom
T: +44 20 7936 1290
F: +44 20 7936 1299
bartsinfo@brunswickgroup.com
www.brunswickarts.com

MERCHANTCANTOS
20 Lincoln's Inn Fields
London WC2A 3ED
United Kingdom
T: +44 20 7242 1336
F: +44 20 7936 7788
office@merchantcantos.com
www.merchantcantos.com

THE LINCOLN CENTRE
18 Lincoln's Inn Fields
London WC2A 3ED
United Kingdom
T: +44 20 7936 1300
F: +44 20 7396 3535
info@thelincolncentre.co.uk
www.thelincolncentre.co.uk

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EDITOR
Jackie Shorey
jshorey@brunswickgroup.com

DEPUTY EDITOR
Carlton Wilkinson

PROJECT MANAGER
Mallory Merge

FEEDBACK
feedbackreview@brunswickgroup.com

DESIGNER
Mia Song

PRINT PRODUCTION
MerchantCantos

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COVER ILLUSTRATION
Oliver Munday

ILLUSTRATION ABOVE
Miguel Porlan

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