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

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.

**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.

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