

# Soft Shareholder Activism

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# Motivation



- Activists have strong view on how companies should be managed
- Criticize managers/directors for lack of competence and accountability
- If they could, they would impose their views on these companies

# Motivation

## But...

- Obtaining control of a public company is not trivial:
  - ▶ must accumulate voting shares, win board seats
  - ▶ how? takeovers, proxy fights, litigation
- Companies can defend themselves
  - ▶ poison pills, staggered board, dual-class structures, etc.
- Securities regulation also puts limits
  - ▶ e.g., filing requirement of schedule 13D
- In practice, activists rarely own more than 10% of the equity, and rarely hold the majority of board seats

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## **Shareholder activism requires communication**

- Communication:
  - ▶ sending letters, calling management, meeting directors
- Agenda:
  - ▶ payout policy, capital structure, strategy, governance, CSR

## Anecdotes

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“When we offer companies **private advice**, they either take it, or they explain why they are not going to take it... sometimes, we agree to disagree, and then decide whether to hold the stock or **exit** the position.”

David Einhorn from Greenlight Capital, 4/25/2017

## Anecdotes

In May 2012, the activist hedge fund Elliott Management wrote a letter to board members of BMC Software:

“we initiated a **dialogue** with senior management about exploring pathways together to create greater value for stockholders. In turn, BMC responded by issuing a press release and adopting a poison pill.”

- Shortly after, Elliott **nominated directors** and pushed for the sale of BMC which was acquired a year later



# Evidence

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- Deloitte (2015): 60% of public company CFOs say activist shareholders have communicated directly with their management
- More evidence: Becht et al. (2009), Becht et al. (2015), Carleton et al. (1998), Dimson et al. (2015)

## This paper

### **Under what conditions communication is an effective form of shareholder activism?**

- What factors contribute to successful dialogues between investors and firms?
- Under what circumstances will investors resort to more aggressive tactics, and when will they choose to exit?
- Why are most communications held behind-the-scenes

# The model in a nutshell

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  - ▶ Behind-the-scenes

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  - ▶ Behind-the-scenes
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  - ▶ Exit: sell her stake (price is endogenous), or
  - ▶ Voice: launch a public campaign
    - ★ campaign is costly, and it succeeds only if shareholders support it

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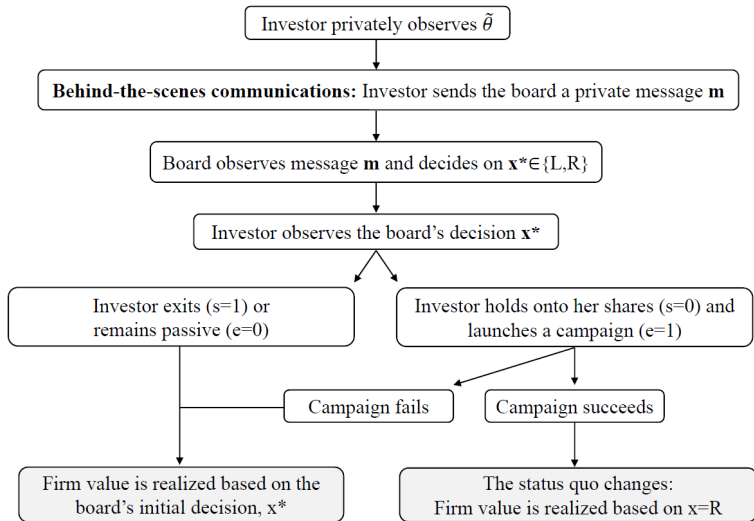
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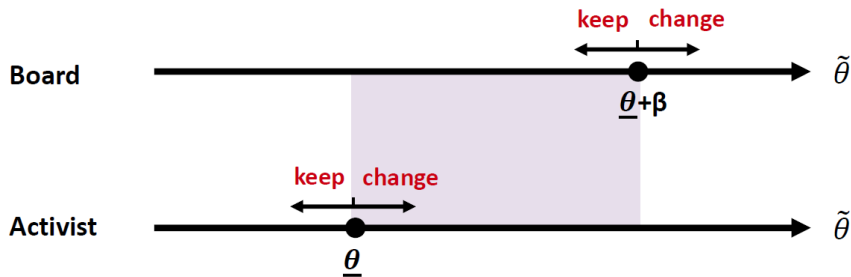
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- Communication is effective if the activist can use her private information to influence the board's decision in equilibrium

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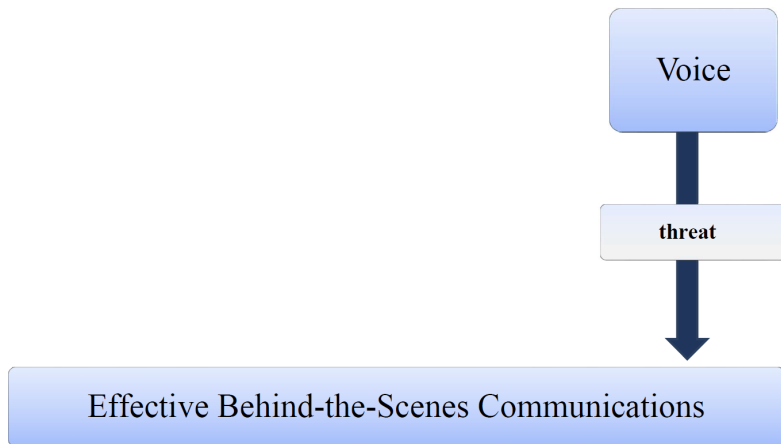


# The key friction

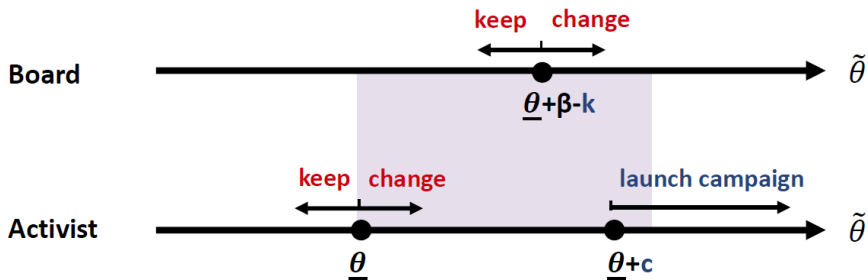
## Communication



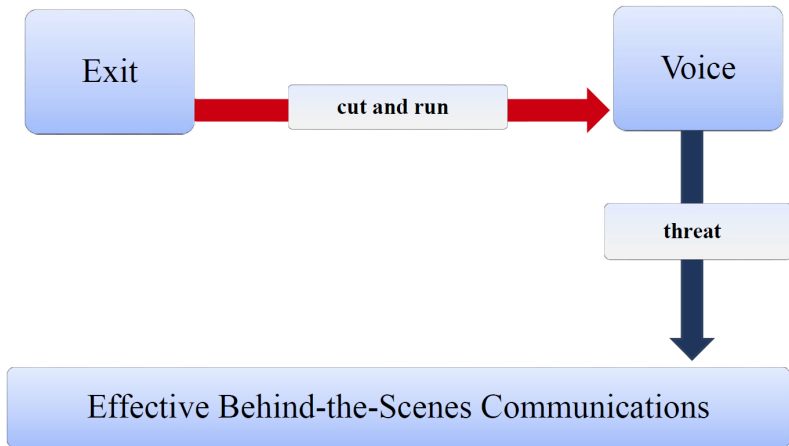
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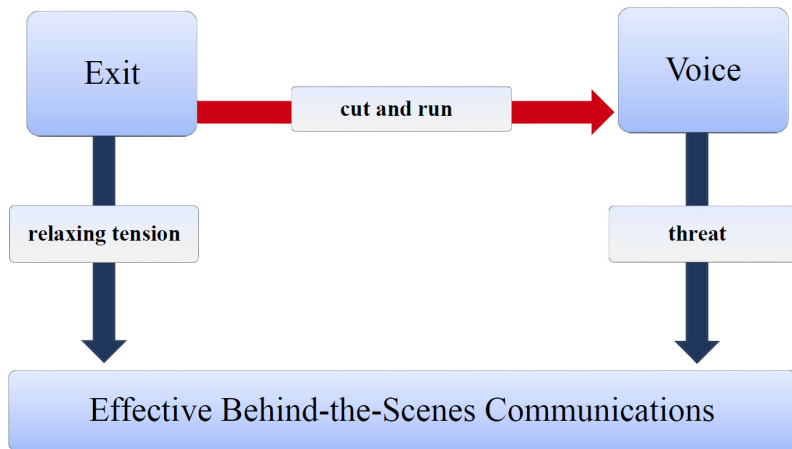
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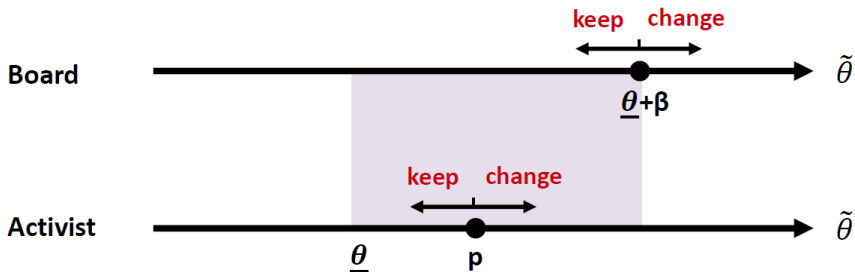
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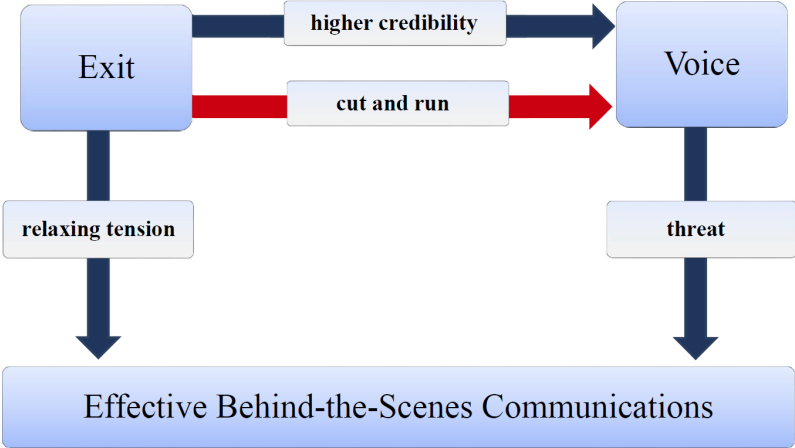


## Communication with **exit**

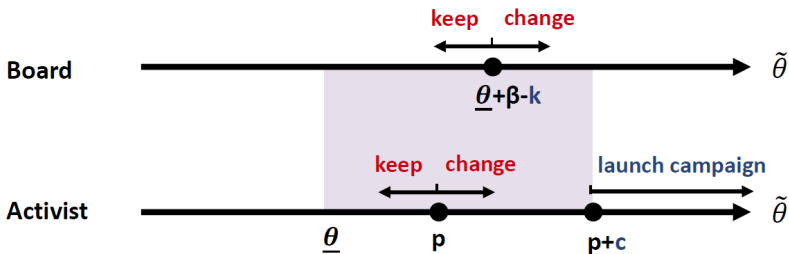




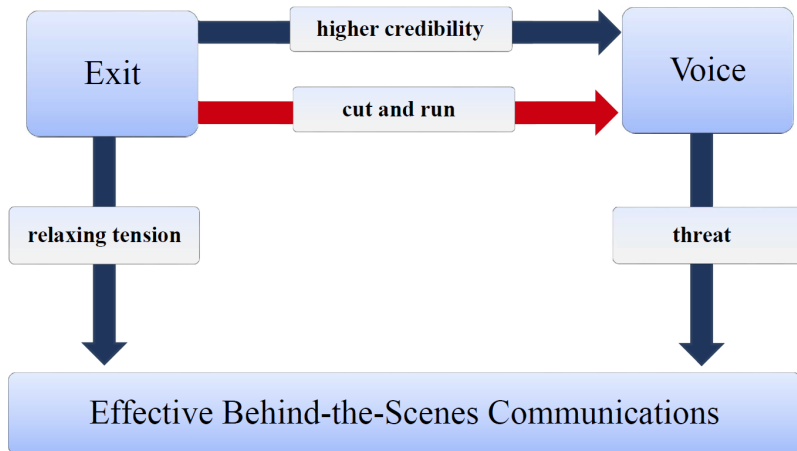
# Communication with voice and exit



## Communication with **voice** and **exit**



## Summary of the main results



## Key takeaways so far

### **Voice enhances communications. Why?**

- The best way to avoid intervention is compliance

### **Implications**

- Communication is more effective when:
  - ▶ shareholder base is non-dispersed and homogeneous
  - ▶ control is contestable (e.g., declassified board, one class of shares, no supermajority provisions)
  - ▶ reputational damage to target board members from a successful campaign

## Key takeaways so far

### **Exit enhances communications. Why?**

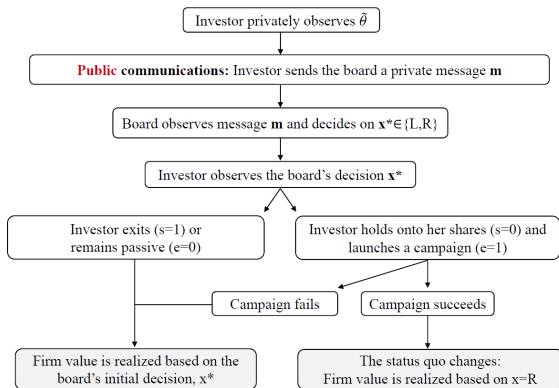
- Relaxing the tension between the activist and the board
- Enhancing the credibility of voice: “put the money where the mouth is”

### **Implications**

- Communication is more effective when:
  - ▶ short-term capital gains taxes are low
  - ▶ anonymous trade is feasible (e.g., weak disclosure requirements or fragmented market structure)
  - ▶ adverse selection is mild (e.g., due to liquidity shocks)
  - ▶ liquid stock

# Public communications

## Why are most communications held behind-the-scenes?



- Market maker and other shareholders observe the activist's message

# Public communications

## Main result

- Public communications are ineffective
- Justifies the prevalence of behind-the-scenes communications

## Why?

- The activist is tempted to manipulate prices in order to secure her exit
- The desire to inflate the stock price diminishes the activist's credibility and limits her influence on the board

⇒ **behind-the-scenes communications are more effective**

## Informed board and alternative sources of private information

**The board may be uninformed (about the benefit from changing the status quo,  $\tilde{\theta}$ ) because:**

- bias
- coordination problems (e.g., free-riding, conformity, group-think)
- conflict with senior management
- busy directors



## Informed board and alternative sources of private information

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- conflict with senior management
- busy directors

**Suppose instead the board is informed, and consider two alternative sources of private information for the activist:**

1. feasibility or consequences of a successful public campaign
2. activist's preferences or beliefs

# Informed board and alternative sources of private information

## Main result

1. Investors cannot credibly communicate information related to their future intention/ability to intervene
  - ▶ activist has incentives to pretend that:
    - ★ a successful campaign is more likely than it really is
    - ★ the consequences to the board are more severe than they are

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## Main result

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  - ▶ activist has incentives to pretend that:
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    - ★ the consequences to the board are more severe than they are
2. Communication must involve value-relevant information
  - ▶ board is interested in learning about the determination of the activist to launch a campaign
  - ▶ activist can credibly convey this information – preventing the board from mistakenly changing the status quo

# Literature

- **Shareholder activism:** Shleifer and Vishny (1986), Kyle and Vila (1991), Admati et al. (1994), Burkart et al. (1997), Maug (1998), Kahn and Winton (1998), Bolton and von Thadden (1998), Noe (2002), Aghion et al. (2004), and Faure-Grimaud and Gromb (2004), Edmans and Manso (2011), Dasgupta and Piacentino (2015)
- **Exit as a governance mechanism:** Admati and Pfleiderer (2009), Edmans (2009)
- **Communication in corporate governance**
  - ▶ **board structure:** Adams and Ferreira (2007), Chakraborty and Yilmaz (2016), Harris and Raviv (2008), Levit (2017)
  - ▶ **managerial compensation:** Almazan, Banerji, and Motta (2008)
  - ▶ **takeovers:** Levit (2017)
  - ▶ **shareholder activism:** Bhattacharya (1997), Cohn and Rajan (2013), Harris and Raviv (2010), Levit and Malenko (2011)
- **Communication & outside options:** Che et al. (2013), Levit (2017), Matthews (1989), Shimizu (2008)
- **Real effects of financial markets:** e.g., Bond, Edmans, and Goldstein (2012, survey)

# Conclusions

**Activists cannot simply force their ideas on companies** ⇒

- They must persuade the incumbent board or other shareholders
  - ▶ ⇒ role for communications as a form of shareholder activism
  - ▶ ⇒ communications are prevalent in practice

## **Main results**

- Voice and exit enhance the effectiveness of communications
- Public communications are less effective
- Effective communication must involve value-relevant information

Thank You