TWO SIDES OF THE STORY: ACTIVISM

Dear Ruud,

Activist shareholders: we saw them in action in 2007, in the ABN AMRO soap opera, and again, more recently, in the KPN and AkzoNobel sagas. But what actually is an activist shareholder or investor? It is an individual or group that buys a significant stake in a public company in order to influence how the company is run, sometimes by obtaining seats on its board of directors. Activist shareholders often see value in a company that the current management is failing to unlock. This could be due to their strategy, but also as a result of decisions about the balance sheet. A number of years ago, for instance, Apple had vast sums of cash on its balance sheet but it did not pay any dividend. That created a perfect opportunity for an activist shareholder. The billionaire Carl Icahn took on the challenge and urged Apple to buy back shares using the cash on the balance sheet. This indirectly led to the cash on the balance sheet (which was thus lying idle) being paid to the shareholders.

“Shareholder activism is an age-old phenomenon.”

There have also been various recent campaigns by activist shareholders in Europe. Unibail Rodamco was forced to forego an extra capital injection because a number of shareholders (including the former CEO) had other plans for the company’s future. Even more recently, several activist shareholders waged a campaign against Danone, which led to the resignation of its CEO Emmanuel Faber. Known for his advocacy of sustainable business practices, Faber had persuaded the shareholders in June last year to consent to a new vision, with Danone adopting the “entreprise à mission” model and bringing ‘health through food’ to the consumer. Getting rid of an enlightened CEO can lead to a company reducing its commitment to sustainability. However, those same activist shareholders point out that other companies dedicated to sustainable practices achieve better shareholder returns than Danone.

Shareholder activism is an age-old phenomenon, evidence of which is even to be found in a number of documents dating from the time of the Dutch East India company. It is interesting to see how it affects an investment. A number of studies cited in the Strategic Management Journal show that returns on shares immediately rise by about 7% after activist shareholders step in. Furthermore, share prices rise by 4.5% to 11.35% within one to three years after that. This is evidently linked to the short-term value creation that mostly activist shareholders are looking for. These shareholders succeed in unlocking the value that the management apparently leaves untouched. What is also striking, however, is that shares lose about 5% to 9% of their value four to five years after activist shareholders step in. This implies that activism could have a less favourable effect in the long term.

The indices of activist hedge funds (which generally play a leading role in campaigns against companies) also register lagging returns in the long term. Over the last ten years, such hedge funds have been trailing both the U.S. and worldwide securities markets by 7.5% and 3.5% per annum, respectively.Put another way, activist shareholders can be good news for investors in the short term but they do not appear to offer added value to shareholders with a long-term investment horizon.

From the point of view of sustainability / corporate social responsibility, my question to you Ruud is therefore: what is the social impact of shareholder activism? And does it contribute to sustainability?

Regards,

Caspar Snijders – Portfolio Manager Equities – ACTIAM

Hi Caspar,

As you say, activist investors and hedge funds often look for short-term value creation. This seems at first sight to be at odds with sustainable investment and corporate social responsibility, where the emphasis is on the long-term effects. But things appear to be changing.

Institutional investors have traditionally determined the sustainability agenda and they provide the basis for compliance with the PRI, the world’s leading proponent of responsible investment. That was followed by “long-only” and private equity strategies, as their longer-term investment horizon assigns higher value to non-financial factors such as CO_2 emissions and water consumption. With both the number of PRI signatories and the assets managed by them having grown significantly in recent years, responsible investment now seems to be becoming increasingly mainstream.

While other asset classes are taking increasing account of sustainability, activist investors and hedge funds now represent a minority within this spectrum. The methodologies and processes used to incorporate ESG factors into decision-making often fail to prove their financial materiality. Therefore activist investors are less concerned with using their influence to make companies operate more sustainably.

This situation is now changing rapidly. Scenario analyses and stress testing are making it increasingly clear to companies what financial risks societal changes are exposing them to. Energy companies, for instance, are now seeing the risks involved in making the transition to a less polluting, greener economy. Such transitions could mean that some sectors of the economy face big shifts in asset values or higher costs of doing business. In addition, given climate change, companies could be faced with physical risks such as extreme weather events, which could directly impact business continuity. According to a study carried out by Cambridge University, extreme weather events, such as flooding, heatwaves, and droughts, could add up to $100 billion of loss every year just by 2040.

“Activist investors are more involved and keener to make their voices heard.”

Although activist investors have traditionally focused on management issues, many are now tilting their campaigns towards other ESG elements, especially climate.

Unlike institutional investors, activist investors are more involved and keener to make their voices heard in this regard. Activist investors can therefore play an important role in bringing about change in companies with high sustainability risks. This means that activist and institutional investors have become highly complementary to each other, thus putting greater pressure on companies to change.

The result of this is that more and more hedge funds are promoting sustainability. In the United States, for instance, former ValueAct investor Jeff Ubben recently set up Inclusive Capital Partners, while Lauren Taylor Wolfe founded Impactive Capital. These funds target companies that are lagging in terms of sustainability (ESG) and they use their influence to achieve behavioural changes in material themes such as climate change, for instance by exercising voting rights at shareholder meetings.

Time will tell whether these changes are lasting and whether activist investors will indeed be able to positively influence the extent to which companies take account of sustainability risks. Such investors will also place a keen focus on financially material ESG themes. They will not be inclined to also prioritise non-financial themes, such as ensuring a liveable wage. In other words, it is not the Holy Grail, but it may force laggards to act on the biggest ESG risks.

Regards,

Ruud Hadders - Responsible Investment Officer – ACTIAM

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CONTACT

Marketing & Communications

+31-20-543 6777

marcom@actiam.nl

www.actiam.com