Shareholder Activists Gear Up for a Busy 2021 – With New Tools and Tactics

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As we near the end of the first quarter of 2021, the number of activist campaigns appears to be on track to outpace last year. In a recent poll of readers, activism research provider Insightia found that 59% of readers surveyed expected an increase in the number of companies targeted by shareholder activists this year compared to 2020.

Corporate management teams also face a very different operating environment from the one that prevailed throughout most of 2020. Last proxy season, the combination of economic disruption and the view from some market participants that the timing wasn't right to wage a proxy campaign, slowed activism. But just as quickly as the markets recovered, activist investors started training their sights at possible targets again.

A key difference this year is that many of the changes in our economy and society that emerged in 2020—including a heightened focus on social justice, racial equality, climate change and other ESG issues—will increasingly find their way into the tactics used by activist shareholders.

Reddit, Robinhood and the Resurgence of Retail Investors

What's more, the GameStop fiasco reminded companies and activists that retail investors can be an extremely influential constituency. Some activists may be hesitant to target a company with a big retail shareholder base, which has traditionally been viewed as pro-management, but others will conclude they can effectively use those small investors to their advantage if they have the right message. While each situation is different, the reality is that the Robinhood/Reddit investor base is much less predictable than large institutional shareholders. Getting retail investors to vote in any proxy fight can be expensive and requires a very smart and tailored strategy.

Retail investors, along with institutions, may also be persuaded by certain ESG issues. These issues have played a central role in activist campaigns in recent years, and we believe the number of ESG-related proxy proposals will only increase in 2021. Expect activists targeting underperforming companies this year to inject ESG issues into their arguments where relevant.

An Increasing Focus on ESG Policies and Performance

Significant capital has been raised in ESG-focused funds over the past year and both activists and companies will court their vote during any proxy fight. The AUM of investment firms and other asset owners who have signed the United Nations' Principles for Responsible Investment totaled $103.4 trillion at this time last year, an increase of 28% in 2020, on top of a 20% increase for 2019, according to State Street. With respect to proxy proposals, more than 850 shareholder proposals related to environmental, social or governance issues were filed and 71 passed during 2020.

Companies are certain to face even more proposals on climate change, diversity and inclusion, racial justice, socio-economic inequality, health and safety, and other ESG-related factors in 2021. Activists will also make some of these proposals part of their demands. In December, CalSTRS announced support for a slate of alternate directors at Exxon Mobil Corp. put forth by new activist Engine No. 1 in a campaign partially on emission reduction issues.

Some boards of directors may be tempted to dismiss an activist investor's focus on ESG as a cynical ploy to exploit the current zeitgeist. But, the fact remains that many investors—not just activists—view ESG factors as material elements of a company's performance—and a failure to address such issues as a significant risk to value.

Taking Companies to Task on Cybersecurity and Covid-19

Given the rising tide of cybercrime, activist investors will likely begin to focus on this issue as a major risk to value, much as they have done with ESG factors. In late 2020, the world learned of sophisticated cyber-attacks on several US government agencies and corporations, which were apparently facilitated by compromising an outside software provider used by those organizations. These attacks are just the latest and most dramatic examples of the enormous threat to companies from cybersecurity incursions, including (but not limited to) malware, spyware, data breaches, ransomware, financial cybercrime, and compromised business e-mail. Global losses from cybercrime in 2020 have been estimated at nearly $1 trillion, up from $600 billion in 2018.

Obviously, a company that has already suffered a cybersecurity breach could be more vulnerable to an activist's criticism on that score. According to a survey by PwC, only 32% of corporate directors think their boards understand their companies' cybersecurity vulnerabilities. Therefore, it seems likely that activists may try to nominate candidates with cybersecurity credentials to serve on the boards of target companies that lack such expertise.

With the benefit of hindsight, activist investors this year also may challenge how well management and the board responded to the Covid-19 crisis. Arguably, it may be hard to criticize a company for failing to anticipate such an unprecedented event. However, activists might assert that management did not fully disclose the financial and operational impact of the pandemic, or did not take appropriate actions to sustain the business through the crisis, keep employees safe and protect stakeholders. The SEC's decision to file charges against a restaurant company for alleged "misleading disclosures about the impact of the pandemic on its business operations and financial condition" suggests that activists may see this concern as a viable line of attack.

Determining Whether You're an Activist's Target

As issues such as ESG, cybersecurity, Covid-19 response and the rise of the retail investor join the more traditional elements of activist campaigns, a logical question for corporate boards and managements is: How can we tell if we're going to be targeted by an activist?

A key part of the answer is to assess the same vulnerabilities of your company that a potential activist would. Compare your financial performance to your industry peers, and look for weaknesses that might be cited by an activist. Ask yourself whether there are aspects of the company's operational capabilities that could be improved, particularly in terms of cybersecurity. Look at your board of directors and assess whether the right skills are represented. With respect to ESG issues, consider whether the company could be vulnerable to criticism in areas such as climate impact, diversity and inclusion, or corporate governance. Even if the company is not a leader in these areas, having well-defined and well-articulated goals and policies may be helpful in responding to an activist challenge

Finally, there is no substitute for knowing—and engaging regularly with—your shareholders. When activists are assessing their chances of prevailing in a campaign, they try to understand who the other shareholders are and what issues concern them. If your management and board have maintained an open channel of communication with shareholders, it's less likely that an activist will uncover some heretofore undiscovered area of disagreement that can become the focus on a successful campaign.