

## From value strippers to value protectors

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“Activist” shareholders have gained notoriety over the past few years, and are an easy target in the current climate when people look for someone to blame for the financial crisis.

Many believe activists are relentlessly short-term in focus and strip value from companies. The investment in **Mitchells & Butlers**, the UK pub group, by Robert Tchenguiz, the British property entrepreneur, is often cited as an example of a deal that led to the company acting against its long-term interests by moving its property assets into a Reit (real estate investment trust).

Similarly, an investment consultant in the US suggests moves by the Children’s Investment Trust and 3G Capital Partners to make **CSX**, the largest freight carrier in the south-eastern US, reduce capital expenditure and distribute the cash to shareholders were short-sighted. “If you look at this from a traditional point of view, you would take the money and go home,” the consultant says. “But railroads are by definition capital intensive businesses and if you look at it from the viewpoint of how this affects your other investments – GM, Toyota or any one of 45 S&P companies – voting for this measure is the last thing you should do.”

There have always been two types of shareholder activists, says Penny Shepherd, chief executive of the UK Social Investment Forum, the responsible finance association – those encouraging short-term financial engineering to “unlock value” and those seeking to improve companies in the interest of their long-term owners.

Research suggests activism can be beneficial for shareholders. A paper\* by a group of US academics acknowledges that “hedge funds increasingly engage in a new form of shareholder activism and monitoring that differs fundamentally from previous activist efforts by other institutional investors”. However, it says hedge fund managers suffer fewer conflicts of interest and are not beholden to managers and that as a result, “hedge funds are better positioned to act as informed monitors than other institutional investors”.

There is a clear distinction between activist investors who are heavily geared and those who are not, according to one leading and high profile activist investor. “There is no doubt that a lot of businesses that engaged in activism did so on the basis of leverage. They have had to deleverage, which has hit returns and ability to continue in business,” he says.

Some hedge funds agitate to bring about corporate change “in an aggressive and selfish manner,” says Adrian Clark, head of corporate law at Ashurst. However, the credit crisis has effectively eliminated this type of activity. For investors with a more thoughtful, longer-term approach opportunities remain, however.

Lars Förberg, managing partner at Cevian Capital, says being leveraged means having to focus on the price of the asset you buy into. By contrast, activists such as Cevian, whose investments include Munich Re, Volvo Trucks and Telia Sonera, take positions for a number of years, often taking board positions. “You cannot be leveraged if you’re on the board because it makes you too short-sighted.”

Many institutional shareholders see themselves as limited in the action they can take because they are invested across the index and do not have the resources to invest in understanding the companies they own. They therefore value the rigorous approach that activist investors are able to take. “It is very resource-intensive, it takes months and large investors cannot systematically research all the companies they own – it would cost too much,” says the high profile activist investor.

Some of the investors in his fund specifically approach the firm asking it to unlock value in companies they own shares in. "They want someone prepared to engage with corporates in a way that protects their value," he says.

This is part of a growing realisation among mainstream investors that they need to be more active. "As shareholders we have not been as vigilant as we should have been," says Karina Litvack, head of governance and socially responsible investment at [F&C](#).

Mark Goyder, founder of Tomorrow's Company says: "The financial crisis is a failure of ownership and we have to learn the lesson."

There has been a failure in the measurement of risk and it would be irresponsible not to sharpen oversight of risks, whether financial or related to issues such as climate change, adds Stephen Hine, head of responsible investment development at Eiris, the ethical investment research service.

John Wilcox, chairman of Sodali, a global consultancy, and an adviser to TIAA-Cref, the retirement specialist, says activists and corporate governance reformers will target companies, particularly in the finance sector, because "they feel very strongly that the retirement savings of millions have been lost because they were thrown into the casino". This will lead to wholesale withholding of votes from directors and the withholding of approval of accounts (only an option outside the US), he believes.

"Shareholder activists are really good at pinpointing areas where an individual company falls short of its peers, but they cannot deal with systemic issues such as incentive structures," says Ms Litvack. Everyone in the chain of ownership is incentivised on a short-term basis, adds Colin Melvin, managing director of Hermes Equity Ownership Service, which represents the owners of \$60bn of assets. "Two years ago, we were challenging investment banks about inappropriate pay and incentives. If others had been doing that, we might not be where we are today."

\*Hedge Fund Activism, Corporate Governance, and Firm Performance (2006), Brav et al

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