Activists Wept for There Were No More Worlds to Conquer

Wall Street Journal
By Dennis K. Berman
April 22, 2014

The Activist Investing Agenda—Buybacks and Cost Cuts—Has Become the Default Boardroom Strategy

"Shareholder value," was once a guiding principle for CEOs and directors. Now it has turned into a brittle orthodoxy.

Investor activists made this so. Using persistent menace and frequent success, their agenda—buybacks and dividends, cost-cutting and tax gambits—has hardened into the default boardroom agenda, too.

If you closed your eyes, you might think this was Carl Icahn squawking: "Our priorities for 2014 are simple, and they're all targeted at increasing shareholder value." But, no, this was an executive of car-parts maker Delphi Automotive PLC just days ago, using the now-standard activist argot.

Activists today have some $100 billion under management, and won a stunning 68% of the proxy contests they entered in 2013, up from 43% in 2012.

Today an activist is the chairman of Hewlett-Packard Co.; has squeezed onto the board of Microsoft Corp., and has shaken up once-impregnable redoubts such as Dow Chemical Co., DuPont Co. and PepsiCo Inc.

This intellectual and cultural takeover, decades in the making, would appear to have reached its triumphant, final plateau.

That's precisely the problem.

Just what does an activist do when investing and activist investing have nearly become one and the same?

What's the value of an activist when most boards have already internalized the activist credo, and in some cases have even accepted an activist into their ranks?

The answer is that the activism market, like any market, has begun to adapt. And this is where things will get very interesting for the future of business. Scarcity is forcing activists to become more than value stockpickers, but exotic and operational nit-pickers on capital structure, products, personnel and R&D costs. They're turning into self-imposed management consultants.

All of this could bring some fresh innovation into the way American companies are run. It also raises the stakes for failure of both activist and company alike.

"The response by intelligent boards to focus inward and view themselves through an activist perspective means it's much more difficult for an activist to find targets," says David Katz, a partner at New York's Wachtell, Lipton, Rosen & Katz, which has traditionally sided with companies against activists.

The exotic came into view on Monday, when Valeant Pharmaceuticals International Inc. announced a pre-emptive alliance with activist William Ackman to coax Allergan Inc. into a $40 billion-plus merger. By any measure this is an unprecedented coupling. It's as if Mr. Ackman is Valeant's bodyguard, brandishing his $4 billion, 10% Allergan stake to keep Allergan in line.

Their arrangement is significant in that it eradicates the final cultural separation between corporate and activist interests.

Before, companies would never dream of such alliances, viewing activists as Wall Street pests with roots in the "greenmailing" days of the 1980s. Today, neither their capital nor their influence can be avoided.

The stock market applauded the approach, pushing up both Valeant and Allergan shares. Similarly, a highly-cited and controversial 2013 study by Harvard Law School's Lucian Bebchuk of 2,000 activist situations found that operating performance at affected companies actually improved over time.

The reality is that most activists have neither the capital nor the pull to complete an Ackman-like maneuver. They're still trying to persuade and agitate against smaller prey.

Which gets us back to the question: Are there enough quality targets to go around? Mr. Katz says no. He found, for instance, 200 activist campaigns in 2013, compared with 27 in 2000. He counts some 100 hedge funds in the market with some history of activism.

"There's a shakeout coming, because we've seen a number of activists focus on smaller companies," says Mr. Katz. "You can't make money that way."

If anything, the future of activism might look something like what's happening at Darden Restaurants Inc., which owns the Red Lobster and Olive Garden chains.

Here two successful activists funds—Starboard Value and Barington Capital Management—are competing to impose their fastidious visions of Darden. As is almost standard now, Darden relented to demands that it spin off Red Lobster.

But that wasn't enough. There's been months of angry back-and-forth about what should be in the spinout, and what Darden should do with its real estate.

There's money, and some glory, to be had at the end of this campaign. Watching the two activists bicker with management, one still wonders just what their fuss is about. Their differences seem small, their rhetoric increasingly shrill.

Is there room for successful activist investing? Of course there is. But it's hard not to expect that, having eradicated frictions in the way, the activist approach is due for its own remake.

In this game, no friction, no pleasure.