Shareholder activists up their game

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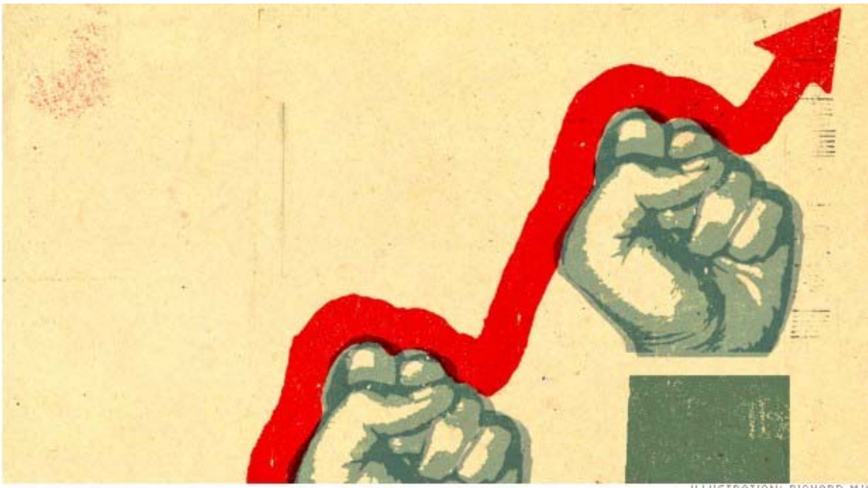

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(Fortune)

If the aim of shareholder activism is to effect change through disruption -- or at least challenge the status quo -- then activist investors are increasingly succeeding. Corporations such as Apple, Canadian Pacific Railways, Procter & Gamble, and Yahoo have already been transformed to some degree through engagement with activists.

The activists have achieved success in those cases because of a growing sophistication in their modus operandi. Ten years ago they were seen as troublesome mavericks. Having typically acquired 5% to 10% of a company's stock, they tended to focus on a single corporate governance issue, such as poison pills, staggered board structures, or, most notably, management incompetence. By contrast, today's activists constitute a credible, standalone asset class, taking a stance on a wide variety of strategic issues in their target companies.

In the wake of the 2008 financial crisis, activists are playing a growing role in countering corporate inertia and clubbiness, in driving M&A activity, and most crucially in unlocking value -- for themselves, for the companies in which they have invested, and for the economy. They are deploying multifaceted campaigns, focusing on core concerns like operations and governance. And they are building a record of success: As J.P. Morgan recently reported, almost all academic research on activist interventions identifies improved stock price and operating performance in the aggregate. Indeed, a sizable subset of interventions produced returns of over 300%.

Understandably with those returns, activists are attracting more money. Over the next couple of years, assets under management at activist hedge funds are likely to reach $100 billion. With the backing of mutual and pension funds (which are less assertive), these hedge funds are achieving greater integration with the companies in which they invest. Only last month, as part of a cooperation agreement following Steve Ballmer's departure, Microsoft gave a board seat to Mason Morfit, president of activist investor ValueAct Capital, which has a $2 billion interest in the company.

Such success is not a given, of course, and not all activist investors are equally diligent or competent. Nor have they always enhanced their reputation by resorting to media attacks on target companies. Disruption of the status quo can be productive if it shifts management's focus to value creation, but excessive disruption can destroy value. Many activists are still learning what level of disruption is appropriate for any particular company.

Activists have become more disciplined, informed, and balanced in their style. Increasingly they are waging discreet, private campaigns to force boards to acknowledge their ability to bring fresh ideas and stimulate performance. Other, more passive shareholders tend to welcome a powerful and rational new voice speaking on their behalf. It is, after all, every board's duty to represent all its shareholders.

Today's activists are ushering in a more open style of corporate culture. Where real power used to reside solely with the chairman and CEO (two distinct roles still too often filled by just one person), it is now becoming more devolved. New checks and balances are providing stronger advocacy for a broad set of stakeholders. Also, as investment capital is reallocated, executives will focus more closely on performance, even long after activists have sold their stake.

One might even claim that the principles of activism could play a part in reengineering the tools for economic growth, both in the U.S. and globally.

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