

## **Exchanges at Goldman Sachs**

### **What's driving the surge in shareholder activism activity?**

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**Allison Nathan:** Even the world's largest companies aren't immune to activist investors. With the management teams of well-known businesses such as Salesforce, Disney and Hasbro attracting the attention of activism campaigns, what are the implications for corporate strategy and shareholders?

**Avi Mehrotra:** One of the activism arguments is the companies should be returning capital more aggressively.

And so I think that the nature of the companies and the nature of the environment and the fact that there is more capital out there is going to create this doubling and tripling up, which we've already seen. And our expectation is that we will continue to see.

**Allison Nathan:** I'm Allison Nathan, and this is Exchanges at Goldman Sachs.

When the stock prices of companies are down, it tends to attract the attention of activist investors, who lobby for changes they hope will improve a target share price.

Joining me today to talk about the evolution of these activist campaigns are Goldman Sachs' Avi Mehrotra, co-head of America's M&A, who runs activism and shareholder advisory, along with Pam Codo-Lotti, who serves as the global chief operating officer for the practice in global banking and markets. Avi, Pam, welcome to the program.

**Avi Mehrotra:** Good to be here.

**Pam Codo-Lotti:** Great to be here.

**Allison Nathan:** It seems every other day we are reading about another new activist campaign, so describe the overall level of activism today and how it compares to pre-pandemic levels. Pam, maybe you can start us off.

**Pam Codo-Lotti:** So before I jump in, when we mean activism, we mean shareholder activism. So these are basically investors that are seeking to agitate to change outcomes. So whether it's around board composition or strategic alternatives or strategic positioning of the company, that's what we mean by activism.

And, look, it's funny because last week we actually had 12 campaigns, so that's almost two campaigns per working days. So very high level of activity. What we see in the public markets is we're back to pre-pandemic levels. But what I find fascinating is when you think about the private level of activity.

So for every campaign that you see publicly, we are working on two or three times the number of campaigns privately. Some of those will become public, and some of those will remain private. So very, very high level of activity right now.

**Allison Nathan:** And what's driving that?

**Pam Codo-Lotti:** When I think about it, I think it boils down to three things really. One, we still are in a very volatile market and valuations are down. And so that creates these fertile grounds for activists. Let's not forget that they're value investors at the end of the day, so it's a lot of targets that they can pick on.

The second thing is really activists have a lot of capital to work with. Some of them were very successful raising capital last year. For example, Elliott raised \$13 billion, the biggest capital raise ever. And that money has to go somewhere.

And the last reason I would say is the number of activists is ever growing, right? You think about what we like to call the first timers or occasional activists. So people who aren't really activists. They are now more and more willing to go public.

And the second sub-bullet on that, if you will, is all these activist funds are spawning new funds. So you have ex-

Elliot PMs raising their own fund. Ex-Icahn launching their own fund. And so the list keeps being bigger and bigger.

**Avi Mehrotra:** I might add that, when you look at the S&P 500 today, one out of four companies in the S&P 500 has an activist in it. And if you look at that in Europe, one out of three companies in the FTSE 100 has an activist in it. So these elevated levels of activity, this proliferation that Pam talked about, we're seeing this in a very meaningful way across geographies.

**Allison Nathan:** And when you say “has an activist in it,” you mean that there is an activist campaign targeted at these companies?

**Avi Mehrotra:** Really, what we mean is there's an activist in the shareholder register. Some of those will lead to campaigns tomorrow. Some of those are active campaigns today. But when one fourth of the S&P 500 has an activist in it and when you think about the holding time and the holding period for some of these activists, which is a little bit shorter than your long-only typical investor, they'll cycle out of those investments and into new ones.

So it's really just a matter of time if you're a large cap company before you might see an activist jump into your stock.

**Allison Nathan:** And if we think about the targets for these activist investors, historically it's tended to be smaller, medium-sized companies because that's where value is often found and where there's more upside potentially. But a lot of the targets more recently have been large-cap companies. So what's driven that change? Avi, maybe you can answer that.

**Avi Mehrotra:** Yeah, I think building on what Pam said, that because there's more activism capital and there are more activists out there, they're looking to invest more efficiently in larger and larger targets. I think it's drawn them towards large-cap companies.

Large-cap companies also have market caps that allow you to enter the stock and exit the position relatively seamlessly. So I think that's also attractive to them. And we're living in an environment right now where the GDP profile is uncertain. It's a harder economic environment. And these larger companies I think afford a little bit of

defensive capabilities to the activists. They're drawn to companies that, in a more volatile economic environment, may be able to ride out that economic environment more soundly.

And so I think for all of those reasons, the fact that there's more capital, they're looking to invest that in larger chunks, they're looking to have fluidity in exiting the position when they need to, and the fact that some of these large-cap companies are viewed as defensive, I think it's drawn them into this nexus of very large corporates.

**Allison Nathan:** And not only is activity up in the space, but there's this trend that is often discussed where we're seeing swarming of activists — so many activists converging around the same company. So what's driving that behavior?

**Avi Mehrotra:** Yeah, look, I think that many of the activists are looking for the same things in terms of what draws them towards a company's vulnerability. And when you've got lots of activists targeting large-cap companies and a finite number of those large-cap companies, it's not surprising to us that we'll see doubling up and tripling up

of activists in these companies. We've seen that notably in the last handful of months. Our expectation is that, as we go through the course of this year, we're also going to see that.

Large-cap companies also in this environment have stronger balance sheets, and one of the activism arguments is a company should be returning capital more aggressively. And so I think that the nature of the companies and the nature of the environment and the fact that there is more capital out there is going to create this double and tripling up, which we've already seen and our expectation is that we'll continue to see.

**Allison Nathan:** And is this really a US phenomenon? A global phenomenon? What does this look like elsewhere in the world outside of the US?

**Avi Mehrotra:** No, I think it's a fantastic observation. In our view, activism has fully become a global phenomenon. If you take a look at Japan, which is not really a place that you would think of to have a lot of activist activity, Japanese companies have been targeted by activists quite pervasively over the last couple of years.



And I think there's some reasons for that.

Japanese companies have strong cash balances, strong balance sheets. In many cases, they also have lots of different business lines, so there's a view in our argument towards pruning the portfolio or optimizing the portfolio. And from a governance standpoint, they've got boards that are a little bit less diversified than US boards either from a gender standpoint or from a skills standpoint.

And so we've seen activism in Japan grow quite in a pronounced manner. And we've also seen activism in Europe flourish quite aggressively. And in Europe, the phenomenon is very much this large-cap phenomenon that we've talked about, where many European companies, particularly the larger ones, are visited not by just European activists but also U.S. activists. And in fact, the average size of a European company that's being targeted by activists this year has been \$40 billion. That's astounding, if you ask us.

**Allison Nathan:** Right. So the companies that are targeted might be international. The investors or the activist investors might be based outside of the U.S. as

well.

**Pam Codo-Lotti:** Correct.

**Allison Nathan:** And Pam, when we think about these activist campaigns today, what are really their major asks? We often think about a spinoff or an M&A outcome being the key goal of activist campaigns, but we're in a very difficult environment, as we've already mentioned. M&A activity is not particularly strong. So what are the outcomes that these activist investors are looking for today?

**Pam Codo-Lotti:** That's a great question. I will maybe separate M&A and spinoff because I do think that investors are still very focused on portfolio simplification, so spinoff divestitures. And they tend to target these days capital-intensive lines of businesses, low-margin businesses. But you're right, on the M&A, or very specifically sale of company, which used to be a major ask, that's going down. And it's being replaced by operational theses, right? And it's about frugality around capital spending, operational efficiencies, margins, profitability. So that's a new theme that we are seeing.

And as I think about it, the environment is ripe for it, right? You have a bunch of companies that, whether it's industrials, tech companies, healthcare companies, that have very high growth, that focused on high growth. And now in this environment, investors at large -- put activists aside for a minute -- but investors at large are saying, "We want more focus on cost. We want more focus on profitability."

So when an activist comes with their thesis around that, they're frankly pushing on an open door. It's very easy for them to gain traction with these kinds of arguments.

The other things we're seeing is capital allocation. So there's a big focus on the return of capital to shareholders, especially for companies with high cash balances and depressed stock prices. But the one thing that's interesting, there's a lot of focus on inorganic growth. So should you really be buying businesses at this point in time? Is it the best way to allocate capital? That's what we're seeing now.

**Avi Mehrotra:** And I might also add that, on the return

of capital point that Pam mentioned, we are coming off of two back-to-back years of absolutely record share repurchases activity. So in 2021, there was almost a trillion dollars of corporate share repurchases. In 2022, it exceeded a trillion dollars. So as we enter 2023, we're coming off the back of a momentum of two very active and record years of share repurchase activity.

**Allison Nathan:** So Avi, what are your thoughts about a slow M&A environment and the implications of that for activist campaigns?

**Avi Mehrotra:** Yeah, so our view is that the M&A environment may be slow right now, but it's going to recover. And when it does, I think the activist demands are going to shift and revert back to many of the things that they had focused on when we had a very robust M&A market, specifically that companies should reevaluate whether they should be sold. So this exploration of strategic alternatives will be back on the table.

**Allison Nathan:** And you talked a little bit on sectors. Are there specific sectors where activist campaigns seem to

be more numerous or focused right now?

**Pam Codo-Lotti:** I think tech continues to be a big target because, again, all these sort of high-growth companies. But we're seeing it everywhere, right? Healthcare, industrials. I don't think any sector is immune, especially if you are a high-growth company that needs to now focus on profitability. I think it's really pervasive right now.

**Allison Nathan:** And so if you look at all of these different campaigns that are going on and ones that have occurred in the past, what will you define as a successful activist campaign?

**Pam Codo-Lotti:** I can start, and I'm sure Avi will have thoughts because we debate that a little bit. Look, ultimate success is you convince your other investors that the board and the management team are doing what they should be doing to drive shareholder value and they're executing on that. And therefore, there's no need for external intervention.

Now, most of these cases never see the light of day because the activist goes away. They know they're not going to have

traction. So that's one.

Another success is, look, if you are in a situation where the company needs to make concessions, for me, success is how do we contain this in the private domain so that we can limit the distraction, the public distraction for the company? Sometimes you have to fight, right? And you just have to do it. But containment is also a form of success.

**Avi Mehrotra:** I would say another way to think about success is that, when an activist targets a company, particularly if it becomes public, it may draw other criticism. It may draw other activists. And so I think another way of thinking about success is that you're able to manage the situation without it proliferating into something that becomes bigger than just the initial attack.

And so I think that there's an enormous amount of focus on getting these things resolved quickly, getting them resolved efficiently, and, particularly as you had raised the question about swarms, those are particularly challenging situations where you've got multiple activists very often who are looking for different things. They are giving you

demands that are competing demands and sometimes inconsistent demands. And so I think success is to make sure that you're not going to the lowest common denominator and negotiating with each one of these individual activists. That you're taking the broader picture into account and resolving it efficiently and quickly.

**Allison Nathan:** We're also about to embark on proxy voting season, which is when most publicly traded companies hold their annual meetings. And this year there's a change in proxy voting rules that lowers the entry barriers for activist shareholders. Avi, can you explain what that change is and what it means?

**Avi Mehrotra:** Yeah. So very simply, it used to be the case that, if you were running a proxy contest, the activists had their own proxy card, the company had their proxy card, and you had to vote one card or the other card. The universal proxy rules allow you to simplify that into one card, and I think that's going to have a couple of different effects that we should keep in mind.

One is that, as you mentioned, it lowers the barriers to entry for an activist attacking a larger company. And I

think in particular, it's going to allow smaller activists, maybe less resourced activists, to go after larger targets. So that's going to be one very important implication.

The marrying up of the proxy card into a unified proxy card will also make it easier for you to pick and choose which directors you want to vote. And so from an activist standpoint, it allows a more efficient targeting of individual directors at a company. And so I think that's another thing that we're going to see.

And then a third effect, which we haven't seen yet but may come later in this proxy season or perhaps in the next proxy season, is that we have talked about activists really as economic actors. And this opens up -- universal proxy opens up the possibility that non-economic actors or someone who has an issue-oriented agenda could decide that they want to put a candidate on a board.

So for example, what is if there is a labor-oriented activist that wants to put a labor candidate on a board of a company that is a very large employer? I think it opens up the possibility for that. So I think the universal proxy, this is the first proxy season that we're seeing it in effect. To



date, the effects have by relatively muted, but we're keeping an eye on it because it has the potential to really change the game around some of these things that we just talked about.

**Allison Nathan:** And finally, given the high level of activism today, are companies taking any steps to inoculate themselves from activists?

**Pam Codo-Lotti:** Yeah, the first step is to what we call think like an activist. What I mean by that is you have to take a very clinical and objective look at your company. And very importantly, you have to do it based on public data. Because as a board and management team, you have information that investors don't have, and you have to look at stock price performance, operational performance, board composition, governance.

And when we do this exercise with companies, what you find is it might lead to changes. So around capital allocation, around return of capital, around portfolio, and sometimes it actually leads to more of a shift in investor messaging because, again, sometimes what creates an activism situation is that the board has a clear view of what

they're trying to achieve. Investors don't have the same view. And so how do you bridge this gap? Sometimes it's with changing the investor messaging and doing these sort of very clinical outside-in analyses helps tremendously for this.

**Avi Mehrotra:** And I would also say that one of the things that I think you need to do is to constantly benchmark your performance against your peer group, and there will be times where the performance is gapping. And if it is, I think you need to have a strategy of communicating to your investors why that's the case in the moment and why that won't be the case a quarter or so from now.

I think that when companies seem that they're reactive, that they're only doing things when a shareholder or an activist is raising the issue, that's when I think you get into a more vulnerable position. If shareholders are used to you grading yourself, being, as Pam said, very clinical about your performance and just being honest about gaps that we might have today but gaps that we expect to close in the near future, I think that's a very helpful orientation that you should have towards your shareholders.

**Allison Nathan:** Avi, Pam, thanks so much for joining us today.

**Pam Codo-Lotti:** Thank you for having us.

**Avi Mehrotra:** Thanks.

**Allison Nathan:** Thanks for joining us for another episode of Exchanges at Goldman Sachs, recorded on Wednesday, March 15th, 2023. If you enjoyed this show, we hope you follow on your platform of choice and tune in next week for another episode. Make sure to share and leave a comment on Apple Podcasts, Spotify, Stitcher, Google, or wherever you listen to your podcasts.

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