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More Activism, Please

BY FRANK WIEBE

Activist investors are the real capitalists who take their ownership rights in a company seriously. We should be encouraging others to do the same, argues Handelsblatt's New York correspondent.

WHY IT MATTERS

The outsize influence of activist investors is a result of other investors' passivity and the complexity of modern finance capitalism, argues the author.

FACTS

Numerous German companies have seen interventions by activist investors in recent years, including VW and Deutsche Bank.

Recently, management at pharmaceutical company Stada has been heavily pressured by Active Ownership, an activist investor.

Some American activist shareholders have managed to achieve returns twice as high as they could have achieved with ordinary investment strategies.

Can they do that? The question that always comes up when a so-called "activist investor" buys a packet of shares in a company and starts making demands. It makes no difference if they are totally unknown, like German company Active Ownership, which has bought into Stada, or a well-known battler like Carl Icahn, who has even been known to pick fights with mighty Apple.

Often with relatively small stakes of 5 percent, and with no personal experience in the sector, these investors can succeed in putting veteran management under serious pressure. Sometimes they are content to make headlines, drive up the share price, then sell their stake at a profit. But often they stay, demanding higher dividends or share buybacks, as Mr. Icahn did with Apple. Or they want a seat on the board, like Nelson Peltz at Mondelēz.

Sometimes they like to play God, forcing through a merger, like Bill Ackman did with the pharmaceutical companies Valeant and Allergan. In this vein, Mr. Icahn has been fond of firing CEOs, as with Cheniere Energy. On occasion has tried to break up large companies, as with the insurance giant AIG.

In purely legal terms, there is nothing wrong with any of this: these people are all acting completely within the law. But are they ethically justified in acting like they own the company, when in reality they only have a small stake?

Activist investors thrive on the passivity of many other investors. Because shares can be sold at any time, it is much simpler to "vote with one's feet" – to sell one's shares – rather than exercise ownership rights at an annual general meeting. In addition, with shareholding increasingly done indirectly through index trackers or funds with automatic management, the living link between shareholders and the company they own has been lost.

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In the past, private investors meekly accepted management suggestions, because they knew no better. Today, ownership rights have largely gotten lost in the dense mesh of capital market structures. Investment companies, even ones like Vanguard with largely passive funds, claim they exert influence on management behind the scenes. But that is impossible to verify. In practice, nearly all funds go along with what they are given. Or actually, what their customers are given.

As a phenomenon, activist investors are only possible thanks to the perverse transformation of the market economy into finance capitalism. In theory, the market economy is based on private property. In many small- and medium-sized German firms the principle is still alive and well. But since the 19th century, the rise of the public-limited company has frequently meant managers disempowering owners and taking away their rights, often in collusion with banks.

This pattern was disrupted with the appearance, some decades ago, of the shareholder value movement. But this did not reactivate private ownership in its original form, along with the necessary responsibility. Instead, since then, managers have reacted above all to their firms' share price. Instead of company owners, managers answer to analysts, who have no responsibility for the companies they analyze, but who do influence their stock prices.

At the same time, the structure of modern finance markets has gotten more and more complicated, and operations have enormously accelerated. "Ownership" should actually mean a long-term relationship, but in today's stock markets, it can change hands several times in fractions of a second. This has made it more and more difficult for responsible managers to do what they are hired to do: to make the best long-term use of their shareholders' capital.

In the world of modern finance capitalism, activist investors seem almost like a relic of a past era. They actually make active use of the ownership rights talked about in economics textbooks. The fact that they can do this with relatively small ownership stakes is because other investors either follow their lead or simply do not exercise their responsibilities.

So yes, they do have the right to interfere. And the best way to limit their influence would be the active participation of many more shareholders.

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