Shareholder activism was a recurring theme across our significant proxy votes this season. We share how we distinguish active ownership from activism and how private engagement can be effective in helping to create long-term shareholder value. Independent, case-by-case judgment remains central to how we exercise our responsibilities as stewards of capital.

INTRODUCTION

As in past years, we use our third-quarter Stewardship Insights article to reflect on a selection of our significant proxy votes, and this season, shareholder activism stood out as a recurring theme across companies and regions. This is not particularly surprising given that activism has been on the rise globally, including expanding significantly outside the U.S. in recent years. The significance of this theme led us to think about the interplay between activism and active management and the subtle differences between the two philosophies. Below, we illustrate these nuances with several examples.

BEING "ACTIVE" DOES NOT NECESSARILY MEAN BEING AN "ACTIVIST"

There is no one clear definition that separates an "active" investor from an "activist" investor. We have, however, always considered ourselves to be the former rather than the latter. For us, the distinction hinges on the tools used, rather than the objective or degree of conviction in the outcome. In other words, we could share the same goals as an activist, but we would typically use different means to try to achieve them. At the most basic level, an activist will typically use more public or quasi-public mechanisms to achieve their objectives (such as public letters, proxy contests, and vote-no campaigns against incumbent directors), while we tend to prefer private, ongoing dialogue.

We spend our time deeply researching businesses to find the ones that are undervalued relative to their long-term earnings potential. This requires ongoing engagement with the management teams of the companies we choose to invest in. Since we view ourselves as part-owners of the businesses in our portfolios, we seek to build long-term constructive relationships with companies, akin to those of a trusted advisor. When we disagree with management, we robustly engage to share the direction that we think maximizes long-term shareholder value.

EVALUATING THE MERITS OF "ACTIVISM"

If we are invested in a company that finds itself the subject of an activist campaign, part of our role is to independently assess the merits of the activist agenda. As the examples below illustrate, we will assess this case by case and exercise our votes accordingly.

Activist Alignment: DB Insurance, Korean Insurance Company

The recent "Value Up" legislative agenda from the Korean government was intended to improve capital efficiency and governance quality among Korean companies. This supportive regulatory backdrop appears to have emboldened activists in the region, and we have observed an increasing sophistication of activism efforts. A Korean activist approached us in an effort to improve governance and capital allocation at a variety of Korean companies this season, of which DB Insurance was a particular priority. In speaking with the activist, we identified overlap between their objectives and those of our separate engagement with DB Insurance. After speaking with both the activist and the company, we voted in favor of the activist's nominees to encourage board refreshment and their shareholder proposal to create an internal transaction committee of independent directors to better oversee related-party transactions. We would have reached the same conclusions had the proposals come from management or another shareholder. Our vote reflects our judgment of what we believe advances long-term shareholder value creation at DB Insurance. While one of the activist nominees was elected, the resolution to set up a transaction committee did not pass. We will continue to engage the board on the importance of prudent capital allocation.

Activist Misalignment: Genesco, U.S. Specialty Retailer

We can also find ourselves in disagreement with some of the specifics of a given activist agenda. We saw this in the case of Genesco, where an activist was pushing for board refreshment and proposed two dissident board member candidates to replace specific incumbent directors on the Genesco board. We engaged extensively with this activist in the lead-up to the proxy contest because we did share the view that board refreshment could help address an extended period of underperformance. Unfortunately, the activist did not nominate candidates with relevant retail experience, and we did not think that their individual experience made them better candidates than the incumbent directors. That led us to support the management slate of directors (who were ultimately re-elected) rather than the activist candidates.

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This example highlights that while we may agree in part with the objective of an activist, the devil is always in the details. We will vote for activist nominees only if we genuinely believe that doing so will result in a more favorable outcome for long-term shareholders.

WE CAN HAVE JUST AS MUCH IMPACT BY BEING "ACTIVE"

Our role as an active manager extends beyond deciding whether we agree with the objectives of activists. We can also directly effect change at these companies and can often succeed through more subtle means. For example, through direct engagement ahead of some votes this season, we were able to get specific ballot items amended to better protect shareholder rights. This meant we could ultimately support these items, and other investors could then vote on what were, in our view, better proposals.

Baxter, U.S. Medical Device Manufacturer
Baxter sought to amend its certificate of incorporation regarding board size, which would have given the board authority to increase the number of directors up to a cap of 17. Academic literature[1] supports our view that smaller boards are associated with better decision making. Baxter's proposed cap was also well above market norms, as boards of large-cap companies comparable to Baxter typically average 10-11 directors[2]. We engaged with the company and shared our preference for a smaller board. Following that conversation, the board adopted an amendment to the bylaws fixing the board size with a range of 7-12 members. We felt this sufficiently addressed our concerns, while still allowing flexibility to appoint new directors when needed. This enabled us to vote for the original proposal and, in our view, improved corporate governance practices at the company for other shareholders. It is perhaps not surprising that the vote ultimately passed.

ArcelorMittal, Global Steel and Mining Company
ArcelorMittal requested the authorization of equity issuance without preemptive rights. We will typically approve these requests, provided the issuance does not exceed 20% of share capital. In the case of Arcelor, this threshold was not specified but was instead left open to past precedent. Calculations by Institutional Shareholder Services (ISS) showed the maximum issuance could have exceeded our limit of 20%. We engaged with Arcelor and encouraged the company to state an explicit limit in the proposal. Arcelor ultimately amended the proposal to reduce and limit the requested authority to 10% of share capital, which allowed us, and other investors, to vote in favor. The resolution passed with 98% support.

IMPACT CAN TAKE TIME

We are also not afraid to push for change that may be difficult to achieve or take time to materialize. For example, we continue to encourage Japanese companies to go beyond simply what is required under the new Tokyo Stock Exchange (TSE) reforms designed to improve corporate governance and capital allocation. Most recently, we decided to advocate for fully independent audit committees[3] at Japanese companies with a three-committee governance structure[4] (the closest in structure to the Western model). Japanese companies had previously been exempted from this engagement priority because of cultural and market norms to have insiders sit on key committees. We chose to define "independence" for former company insiders using a five-year cooling-off period, as this reflects the most robust standard among global market norms.

Sumitomo Mitsui Financial, Japanese Multinational Bank
Given that Sumitomo has a three-committee structure, we chose to express our new preference for a fully independent audit committee through our votes. This meant voting against one former executive on the audit committee who had not yet passed the five-year cooling-off window. While our decision to vote against this individual did not materially affect the vote outcome, we believe that voting is a helpful tool to escalate our engagement with companies in the Japanese market. Over time, this approach will show companies that we are serious about advocating for greater independence on audit committees.

CONCLUSION

The common thread across all these examples from the season is the application of independent, case-by-case judgment. In our view, it is that judgment which allows us to have real-world impact through our stewardship and engagement efforts. We will continue pursuing impact through our own fundamental research and active ownership while supporting change at a company when we think it serves the best long-term interests of shareholders and, ultimately, our clients.

1 See https://www.pzena.com/americas/investment-professionals/insights/assessing-corporate-governance/
2 Spencer Stuart Board Index

3 It is our view, based on academic evidence (see footnote 1), that the independence of the audit committee is one of the most important signals of future company performance.
4 Japan has three governance structures: the traditional Statutory Auditor model, where non-director auditors separately oversee the board; the Supervisory Committee model, which integrates oversight into the board through director-members with voting rights; and the Three-Committee model, which separates nomination, audit, and compensation oversight and most closely resembles Western governance structures.

FURTHER INFORMATION

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