CHAZEN INSTITUTE RESEARCH BRIEF

When a Proxy Fight Ends in a Settlement

KEY TAKEAWAYS

- Activists are increasingly entering into settlement agreements with target companies and instead of pushing for overarching structural changes they are settling for board seats.
- Settlement agreements are more likely to occur closer to a company's annual shareholder meeting.
- Settlements often result in an increase in the number of activist-affiliated and activist-desired directors, and a decrease in the number of long-tenured directors.
- Settlements that result in changes to board composition are typically followed by increases in CEO turnover, increases in payouts to shareholders, and improvements in stock prices and valuations.

Proxy fights have become commonplace in the boardroom. The result of these fights, however, is shifting. More and more, activists are reaching settlement agreements with target companies that focus on seemingly superficial changes to board composition, rather than leadership or structural changes.

In "Dancing with Activists," **Wei Jiang, Chazen Senior Scholar at Columbia Business School**; Lucian Bebchuk, professor at Harvard Law School; Alon Brav, professor at Duke University's Fuqua School of Business; and Thomas Keusch, assistant professor at INSEAD, analyze the drivers, nature, and consequences of such settlement agreements. Their findings shed light on how activists bring about change in corporations.

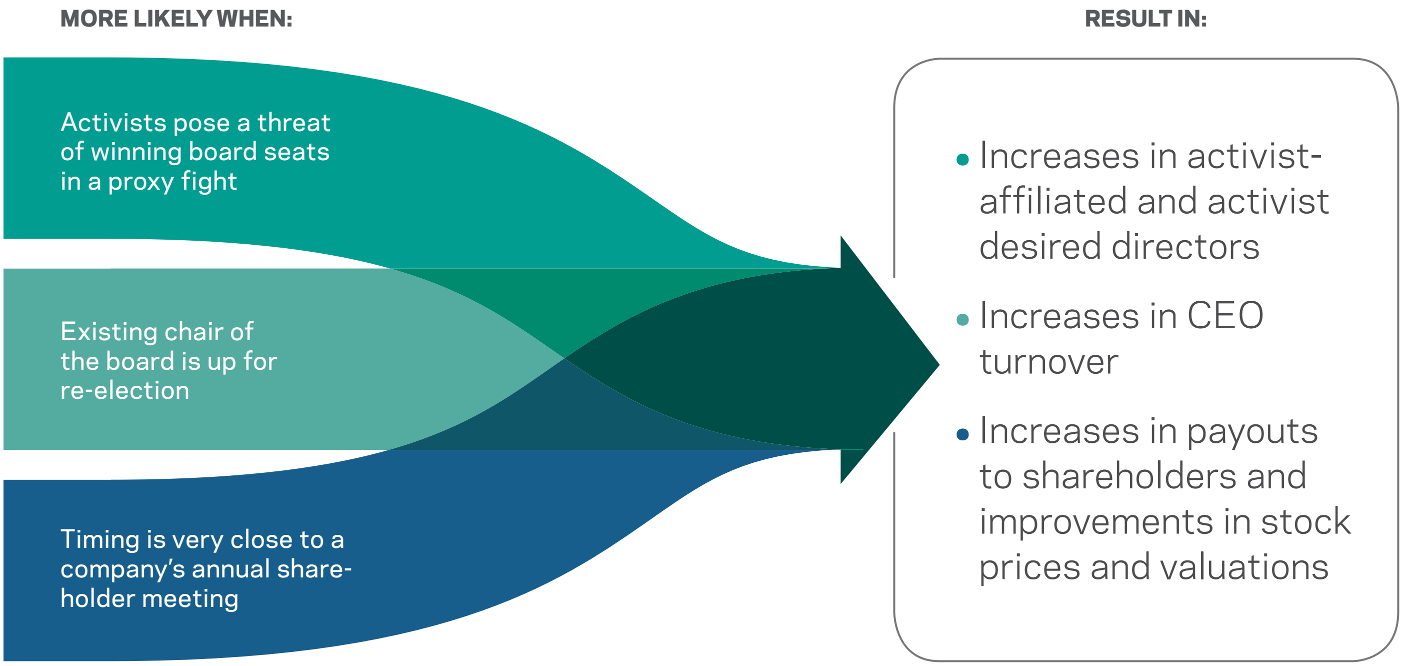
Research

Using a comprehensive, hand-collected dataset, the researchers evaluated common drivers of settlement agreements and their growing prevalence. In addition, they studied the terms of settlements, and analyzed their impact on board composition, CEO turnover, payouts to shareholders, M&A activity, and stock performance. This is the first study to provide a systematic, empirical investigation of settlement agreements between activists and target companies.

Results

The analysis reveals that settlements are more likely when the activists have a credible threat to win board seats in a proxy fight. Settlements are also more

Settlement Agreements



likely when the existing board of directors face significant reputational concerns if the proxy contest continues, for example, when the chair of the board is up for re-election. Given the pivotal nature of these circumstances, the researchers find that settlements often occur very close to a company's annual shareholder meeting.

The researchers also find that settlement agreements generally focus on board turnover rather than addressing the operational and leadership changes activists are ultimately seeking. They offer three potential reasons for this: "incomplete contracts" that leave room to address the core issues, face-saving benefits, and situations where one party has more or better information than the other. These factors combine to preclude or discourage the incorporation of specific commitments for direct action.

The researchers show that such settlements bring about an increase in the number of activist-affiliated and activist-desired directors, and decrease the number of long-tenured directors.

In addition to changes in board composition, settlements are typically followed by increases in CEO turnover, increases in payouts to shareholders, and improvements in valuations. Indeed, the disclosure of settlements is accompanied by positive stock price reactions of one to two percentage points, with higher returns accrued to "high impact" settlements, which involve turnover of over two directors and/or a plan to pursue strategic options. And contrary to popular belief, the researchers find no evidence that settlements allow activists to appoint directors who are not supported by other shareholders or that they enable them to purchase enough shares to challenge existing leadership and force a hostile takeover of the target company.

Download the full paper.

Read about the scholar.

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