Steel Partners activism efforts at United Industrial, Ronson, and BKF Capital: The Good, the Bad, and the Ugly

Timothy A. Kruse
Xavier University, Department of Finance
Williams College of Business,
3800 Victory Parkway
Cincinnati, OH 45207-5162, USA
kruset@xavier.edu

Kazunori Suzuki
Chuo University, Graduate School of International Accounting,
42-8, Ichigaya-Honmuracho, Shinjuku-ku, Tokyo 162-0845, JAPAN
ksuzuki@tamacc.chuo-u.ac.jp

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Abstract
We examine Steel Partner’s investments and shareholder activism at three firms, United Industrial Corp (the Good), Ronson Corp (the Bad), and BKF Capital (the Ugly). The cases suggest the following points. For managers and boards wishing to maintain their independence the lesson is to dig in and refuse to negotiate, preferably while maintaining a big ownership stake. However, forcing the activist to go hostile might not be a great idea as it might lead to a lawsuit or an insatiable wolf-pack type campaign. For the activists, patience can be a virtue. However, do not let the desire for “success” come at the expense of profitability. Success was achieved at BKF and was probably a quixotic venture at Ronson. In both cases, Steel Partners lost a great deal of money and experienced opportunity costs. In contrast, Steel involvement at UIC can be seen as a model of successful activism, both in terms of achieving goals and making a substantial profit.
1. Introduction

Hedge funds have been among the most vocal shareholder activists in recent years. A recent survey of activists indicates the trend will only get stronger in 2009.\(^1\) There are several broad studies of hedge fund activism.\(^2\) Generally, the studies find positive abnormal returns surrounding the filings of Schedule 13Ds indicating the acquisition of a 5% stake and the possibility of efforts to influence management. However, it is less clear whether all the motivations for the activism are value enhancing. Greenwood and Schor (2009) report the abnormal returns are significant only if the target firm is ultimately acquired. Moreover, the studies find mixed evidence regarding the long term impact of the activism on both share price and operating performance.

Perhaps the reason for the mixed evidence regarding the long-term performance is that successful activism is difficult to define. For example, managers desiring the “quiet life” (Bertrand and Mullainathan, 2003) might accede to a portion of the activists demands simply to get the activist to go away. Moreover, even successful activism might have unintended consequences which are not value enhancing.

Managers of the target companies frequently complain that outside activists do not have the necessary expertise to understand the business of the target. Moreover, many managers will see the effort as a threat to their jobs or autonomy. As a result, it is likely that the target management will resist making the changes proposed by the activists. Alternatively, they will try to do just enough to make the activist turns its attention elsewhere.

In addition to differing performance among hedge fund targets, there is little agreement about even the desirability of this activism. The large block holdings amassed by hedge funds

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1 Pensions & Investments (Barry B. Burr), November 18, 2008.
aids in overcoming the free rider problem (see Grossman and Hart, 1980, Shleifer and Vishny, 1986). However, hedge fund activists are frequently criticized for their short-term outlook and for their narrow focus on their own interests as opposed to those of shareholders in general (see Kahan and Rock, 2007 for a thorough discussion of these two criticisms).

We focus on the activism efforts of Steel Partners. Steel has been one of the more active funds; from 1995 to 2006, they filed 13D forms at 63 companies. We examine three of their targets – BKF Capital Group Inc. (BKF), United Industrial Corp (UIC), and Ronson Corp. Steel’s activism at these companies achieved remarkably different degrees of success.

Our examination of the activism efforts at the three companies yields some interesting lessons. One definition of a successful campaign employed by current empirical studies is a campaign in which the target management agrees to at least some of the hedge fund demands. However, the BKF example clearly indicates this definition is problematic. BKF quickly compromised and altered its governance structure in the face of a concerted “wolf-pack” campaign. Even so, Steel Partners continued its proxy fight, winning three seats. Unfortunately, Steel did not adequately consider the ill-will its campaign engendered at the target. Many key fund managers left, taking their clients with them. Over the fifteen months following the proxy fight victory, BKF returned -89.4% before delisting by the NYSE.

The longest post-filing windows used to examine performance among current studies are three years (Clifford, 2007) and 18 months (Brav et al., 2008, Greenwood and Schor, 2009). Steel’s experience at UIC clearly indicates these windows months are insufficient. While UIC returned 53.3% and 122.2% over the 18 months and three years following Steel’s initial filing, UIC’s share price increased by 800% during the 98 month interval between Steel’s initial 13D and its acquisition by Textron in November 2007.

3 Note that Steel Partners has engaged in activism efforts in other countries, most notably Japan.
A primary difference between the BKF and UIC cases is Steel was much more patient in the case of UIC. With BKF, Steel continued despite many management concessions and ultimately suffered a large loss. However, the Ronson affair indicates no amount of patience will guarantee good returns if the activist does not choose its target with care. Steel first targeted Ronson in 1997 and finally transferred a portion of its stake to another investor in July 2009 (thereby bringing its stake below the 5% reporting threshold). Steel did not achieve a single goal over the entire period. The primary reason was Ronson steadfastly refused to negotiate or meet with Steel’s representative beyond one early meeting in May 1997. Ronson was able to withstand Steel’s efforts, in part because its CEO controlled 39.9% of the shares prior to Steel’s initial filing. The four studies listed in footnote one do not provide data on the share ownership of target firm management or use ownership in cross-sectional analysis of returns.

2. Brief overview of hedge fund shareholder activism studies

There are several broad studies of shareholder activism by hedge funds in the U.S. While these studies are similar in using 13D filings to create their samples, some (e.g., Klein and Zur, 2009) do not include non-confrontational activism. Plus, they typically have different approaches to the identification of control firms. Even so, a few common themes emerge. The typical target of the activism is relatively small, has more cash than their controls or industry, has exhibited solid operating performance, but has lower market to book ratios.

Overall, the studies find significant abnormal returns of roughly 5 to 11% in the period surrounding the 13D filings. However, the returns are greatest when the desired outcome is the sale of the target company and are not always significant given other activism goals. For example, Greenwood and Schor (2009) focus on the impact of the sale of the target firms on
performance. They report the abnormal returns in both the short and long terms are significant only if the target firm is put into play and ultimately acquired.

The studies suggest typical goals of the activism involve changes in the board (including representation), the relaxation of takeover defenses, changes in payout policy, and the sale of all or part of the target company. Activists are successful in achieving a portion of their stated goals in more than half of the cases. There is less agreement regarding the post-filing changes in operational performance but most of the studies find small increases in payout policy and earnings (e.g., Brav et. al, 2008). Finally, where reported, the typical holding period is relatively short, less than two years.

In a clinical study, Becht, Franks, Mayer, and Rossi (2009) examine the efforts of one investment company, the Hermes UK Focus Fund and find evidence of abnormal returns when the fund was successful in achieving their goals. As with the broader samples, the highest returns are associated with restructuring activities such as asset sales. They also argue that U.K. law is much more shareholder activist friendly than U.S. law. As a result, British managers are more likely to be receptive to comments and suggestions from activists.

3. Background regarding Steel Partners

Steel Partners II, L.P. is part of the Steel Partners Group, an investment company co-founded by Warren Lichtenstein in 1990. As of October 2007, the Steel Partners Group had $6.76 billion under management primarily invested in public and private debt and equity. Steel Partners II had approximately $2.65 billion under management including investments in other funds operated by the group. Other group funds include Steel Partners Japan Strategic Fund

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4 Much of the following information comes from a prospectus for SP Acquisition Holdings, Inc., a blank check company created by Steel Partners, for the purpose of making one or more acquisitions. The prospectus was filed with the SEC on October 12, 2007 and is available on Edgar.
Steel Partners does not like the term “hedge fund.” Instead, they prefer to be known as a
“Private Investment Partnership” pursuing a strategy of “Relationship/Active Value Investing.”
Its goal is to “identify and make long-term investments in undervalued public and private
companies and work with management to increase value for all shareholders over the long term.”
Indeed, many of Steel’s portfolio positions extend to “three to five years or longer.” In a
separate interview, Lichtenstein added, “We’re called a hedge fund because of our fee structure,
but we’re just a partnership that can invest in public and private companies. We hedge by buying
cheap.”

The SP Acquisition Holdings prospectus provides a good overview of the Steel Partners
strategy, “We intend to benefit from the investment criteria employed by Steel Partners Group.
We will seek to acquire established businesses that are easy to understand. Additionally, we will
target businesses that we believe are fundamentally sound but potentially in need of certain
financial, operational, strategic or managerial redirection to maximize value. We do not intend to
acquire start-up companies, companies with speculative business plans or companies that are
excessively leveraged.”

Steel has been active over the years. Since beginning electronic filing with the SEC in
July 1995, it has filed 63 initial Schedule 13D forms. According to press accounts, it has been
remarkably successful earning 25% per year from its founding through 2003. It earned an

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5 Letter from Steel Partners Japan Strategic Fund dated May 11, 2007 to Bull-Dog Sauce Co. Ltd. downloaded from
6 Ibid.
8 SP Acquisition Holdings, Inc. prospectus filed with the SEC on October 12, 2007, page 2.
9 Sacramento Bee, November 15, 2004, page D1, quoting a Steel Partners newsletter.
additional 35% after fees in 2004. Historically, Steel focused on targets with a market capitalization of around $100 million. However, its current targets are worth up to $10 billion.

As of October 2007, Steel had over 35 employees working in New York, Los Angeles, London, Tokyo, Hong Kong, and Beijing. Nine Steel partners sat on 15 boards globally. Lichtenstein has been active in this regard, sitting on at least 20 boards in recent years and chairing at least five of them.

While Steel’s primary operations are in Japan and U.S., it has acquired positions in Europe, China and South Korea. It joined with Carl Icahn to undertake a vocal activism campaign at the Korean company KT&G in 2006. In the course of this campaign, Lichtenstein became the first foreigner to win election as an outside director of a Korean company.

4. Three targets

We chose Ronson Corporation, United Industrial Corporation (UIC), and BKF Capital Group, Inc. (BKF) as the focus of our study. These firms are typical Steel targets and the methods employed by Steel are representative of its general activism strategies, but the outcome of the Steel’s activism to the three firms greatly differs. That is, the three cases encompass outcomes that might be expected from any activism campaign; the target complies and firm performance improves, the target complies and the performance deteriorates, or the target adopts a hostile attitude. As for identifying targets, Steel looks for undervalued stocks with good potential returns. Standard language in Item 4 in many 13Ds indicates a preference for undervalued companies: “The Reporting Persons purchased the Shares based on the Reporting

11 SP Acquisition Holdings, Inc. prospectus filed with the SEC on October 12, 2007.
Persons' belief that the Shares at current market prices are undervalued and represent an attractive investment opportunity.”¹³

Table 1 reports selected unadjusted and adjusted financial and market variables. In obtaining adjusted figures, the comparison firms are the ten closest GICS sub-industry firms as measured by total assets for year -1. In aggregate, the targets exhibit average characteristics with some interesting deviations. In particular, BKF underperformed its industry peers on a variety of measures. Both UIC and BKF have no long-term debt while Ronson has considerably more debt than its industry peers. Only UIC has more cash than its industry peers. Klein and Zur (2009) reports hedge fund activism targets hold significantly more cash but have insignificantly different leverage than their industry peers.

Table 2 describes the governance of the firms prior to targeting. In many respects, Ronson would seem like an ideal target. It has a long serving dual CEO/Board Chair who is the grandson of the founder and a classified, captive board including the CEO’s son. However, from a strategic standpoint Ronson is not be an ideal choice. The CEO also controls 39.9% of the votes, which practically guarantees a majority on any item coming to a vote. In contrast, BKF’s board was notable for its many well known and/or high powered members including Burton Malkiel, Barton Biggs, and James S. Tisch, CEO of the Loews Corporation.

Table 3 reports primary dates of Steel’s involvement with each target. The duration of Steel’s share ownership at each target is considerably longer than the 22 months estimated by Brav et. al. (2008). Steel quickly reached its maximum ownership position at both BKF and Ronson. At Ronson, Steel’s stake was just short of 10% by December 1998 (at which time Ronson adopted its poison pill) and remained near that level until they transferred a portion of their shares in July 2009. Steel’s Ronson investment lasted more than 13 years. In the case of

UIC, Steel steadily increased its stake, reaching a peak at the time of Textron’s acquisition of 19.6%, which Steel tendered. For BKF, Steel sold their shares on the open market 3 years, 3 months after the first known acquisition.

Steel Partners followed a similar approach with all three target firms, beginning with several attempts to privately communicate and meet with the management and board. Then Steel would begin its public campaign with letters to the board which would be simultaneously disclosed in 13D filings and press releases. These initial letters would be cordial and carefully explain Steel’s primary concerns. Given their initial failure in all three cases, Steel followed with threats of proxy fights and shareholder proposals. In the case of Ronson, Steel also made two offers to buy Ronson and eventually filed suit.

Table 4 outlines Steel’s concerns at each target firm. Generally, the concerns involve looking for ways of adding value via asset sales or the sale of the entire company, the reduction of management entrenchment via takeover defenses and board structure, and excessive compensation and high costs in general. In this regard, Steel is similar to the hedge funds studied by Brav et. al. (2008), Greenwood and Schor (2009), and Klein and Zur (2009).

The history of each targeting effort features several points of interest.

4.1 Ronson Corp.

As noted in Table 3, Steel began acquiring Ronson shares in June 1996. The first publicly disclosed contact with the company was a board meeting attended by Warren Lichtenstein in May 1997. This meeting would appear to be the high point in the relationship. While Steel made repeated requests to meet again with Ronson’s board over the years, Ronson steadily refused unless Steel agreed to answer a variety of questions about Steel’s business practices. Moreover following the meeting, Ronson reflexively rejected every proposal and adopted a new poison pill.
in December 1998. Over the years, communications between the parties in the form of publicly released letters and press releases became increasingly bitter.\(^{14}\)

Early on, Steel made two offers to purchase the company pending due diligence. The initial offer of $5 per share, made in August 1998, was directed first at Louis Aronson, Ronson’s CEO and the grandson of the company’s founder. Then if Aronson sold his shares, Steel would expand the offer to include all shareholders. Aronson’s response was typical of all his dealings with Steel over the years. In a company press release dated August 17, 1998, he said “I cannot think of a greater disservice I could do to our stockholders than to turn control over to Mr. Lichtenstein and his group. While Mr. Lichtenstein might claim to be acting in the best interests of Ronson stockholders, his record belies that claim.” Steel formally asked for a shareholder list during the second attempt to buy the company in early 1999. Ronson dealt with this offer by simply refusing to release the list, citing a legal technicality.

Steel also made shareholder proposals calling for the assessment and possible sale of Ronson’s various divisions (1998) and for the removal of Ronson’s poison pill (2002). Ronson’s management responses were atypically strong. In addition to the defending the policy or bylaw, the responses gratuitously criticized Lichtenstein personally and Steel Partners’ investment style and unrelated business dealings.

Given the failure of their usual methods, Steel filed suit in 2003. The complaint targeted the excessive compensation paid to Aronson and his “cronies” during a period that Ronson’s share price steadily decreased. It also cited a “sweetheart” consulting deal accorded to Ronson’s

\(^{14}\) A good example is Ronson’s letter to Warren Lichtenstein dated November 23, 1999 which includes, “As we have noted in our prior communications to you, take-over scavengers such as you and your organization, are not altruistic. Your interests are totally self-centered and self-serving. Your past history indicates that independent investors of target companies where you have forced yourself into control have received little, if any, benefit in sharp contrast to you and your secret investors’ financial gains. … Furthermore, where you have gained control, your tactics have additionally harmed employees, suppliers and the communities.” Ronson press release, November 23, 1999.
largest non-management shareholder, allowing the company to control another 12% of the vote. Ronson fought back with countersuits of its own. Steel received favorable rulings on the excessive compensation “vote buying” charges on May 15, 2006.\footnote{Steel Partners press release dated May 15, 2006.} Other charges were dismissed and Ronson appealed the ruling. The various suits were finally settled in December 2007. The terms of the agreement calls for Ronson to allow its poison pill to expire by September 2011 and for Steel to refrain from proxy activities for an unspecified period.\footnote{Ronson press release dated October 16, 2007.}

Steel’s involvement with Ronson has not been profitable. The initial 13D filing of March 11, 1998 shows the purchase of 189,699 shares (a 6.0% stake) at a cost of $497,869. Since then, Steel has purchased additional shares and a bond subsequently converted into 1,273 shares. Moreover, Ronson has executed 105 for 100 stock splits in each of 2002 to 2008. In total, Steel’s current ownership position reached 483,035 shares representing a 9.5% stake. The aggregate cost of this position was $1,026,435. Steel made a distribution of 271,319 shares to its indirect shareholders on July 15, 2009 leaving them with a stake of 211,316 shares representing 4.2%. As of September 29, 2009, Ronson’s share price is $0.159. Thus, Steel’s position has a value $33,599, representing a loss of $992,836 over the 13 plus year holding period. Moreover, Steel’s legal expenditures were likely substantial given the lawsuit consumed more than four years.

4.2 BKF Capital Group, Inc.

The BKF affair provides an interesting, if cautionary, contrast to Ronson. With BKF, Steel’s successful campaign culminated in a proxy fight victory yielding three seats on the board. However, that victory was the highpoint. BKF’s CEO-founder John Levin quickly departed with many of his clients. Within a short time, BKF was a shadow of its former self with only three employees and no assets under management.
BKF had already been a target of shareholder activists. On May 29, 2001, BKF’s board adopted, without a shareholder vote, a poison pill with a trigger point of only 10%. Beginning with the 2002 annual meeting, GAMCO Investors, Inc. made three shareholder proposals calling for a vote on the pill’s adoption. All the proposals received a majority of the votes cast, including more than 90% in 2003.¹⁷

Steel Partners added some quiet diplomacy in the months leading up to their initial 13D filing in December 2004. Following that filing, events unfolded very quickly. In February 2005, Steel informed BKF of its intention to nominate three director candidates, including Warren Lichtenstein. By March, a “wolf-pack” of activists was circling. On March 22, the activists filed a joint preliminary prospectus looking to substantially overhaul BKF’s governance structure. Steel nominated their candidates and made a proposal calling for the elimination of the classified board, GAMCO once again filed a proposal asking for the redemption of the poison pill, and Opportunity Partners L.P. filed a proposal recommending the engagement of an investment banker to pursue the sale of the firm.

Yet another hedge fund activist, Cannell Capital, joined in with two incendiary letters. The first letter indirectly accused BKF board of arrogance and corruption, quoting a vitriolic speech from 63 B.C. by Cicero to the Roman Senate. It went on to discuss the common concerns regarding BKF including fund manager compensation, the generous consulting agreement given to Levin’s daughter, and BKF’s lavish offices in Rockefeller Center commenting “One would expect such deportment from scalawags, but not you noble nabobs of Wall Street.”¹⁸

BKF gave in quickly in the face of the onslaught, agreeing to eliminate the classified board, the poison pill in the event of an offer for the company, and the supermajority provision

¹⁷ Gabelli press release carried by Business Wire, May 13, 2004 and BKF Capital proxy statement dated April 15, 2004, obtained from EDGAR.
¹⁸ Letter from J. Carlo Cannell of Cannell Capital, included as an appendix to its June 1, 2005 13D filing.
for mergers. Moreover, BKF agreed to step up efforts to hire a new Chief Operating Officer and declared a $0.925 per share special dividend.\textsuperscript{19} However, Steel continued its proxy fight and handily won the director elections on June 23. One interesting aspect of the fight only came out months later when Carl Icahn revealed he had privately suggested Steel accept BKF’s concessions and withdraw the dissident slate.\textsuperscript{20}

The proxy victory proved to be the high point of the affair as BKF quickly began losing clients and fund managers. Levin left to create a new investment venture which was permitted under agreement with BKF to solicit up to $2.5 billion of BKF’s assets under management.\textsuperscript{21} Other managers left in the wake of an attempt to change the compensation structure. By the end of 2006, BKF had only three employees and no money under management. Moreover, its 2006 revenue fell by 80% from 2004, the final complete year under the previous management.

Steel quickly gave up, initiating selling efforts in fall 2006 and reducing their stake to one share on May 29, 2007. The sale proceeds ultimately totaled $2,067,913, including a final disposal of 436,300 shares at an average price of $2.45 on May 29, 2007. Steel’s position had reached its peak on June 23, 2005 at 727,200 shares with an aggregate cost of $20,421,809.

One final note of interest is that Webfinancial Corp, a Steel subsidiary, purchased an 8.1% stake in BKF in July 2007. They then sold the stake in June 2008. As of September 2009, BKF traded on the pink sheets at $1.00 and had one employee.\textsuperscript{22}

4.3 United Industrial Corp.

Steel’s involvement with UIC might be an ideal model of shareholder activism, both in terms of successfully lobbying for change and in making a huge profit. From the outset, UIC was

\textsuperscript{19} BKF Capital Group press released carried by Business Wire, April 6, 2005.
\textsuperscript{20} \textit{Daily Deal/The Deal}, November 1, 2005.
\textsuperscript{21} BKF Capital Group press released carried by Business Wire, August 23, 2005.
\textsuperscript{22} BKF’s share price hit its all-time high of $42.89 on March 7, 2005 near beginning of the proxy fight.
a good target. Just prior to Steel’s involvement, officer and director share ownership was less than 1%. In contrast, institutional ownership was relatively high – the top three investors collectively owned 25.8%. Moreover, as can be seen in Table 1, the firm had a lot of cash, no long-term debt, and poor operating performance.

The first public contact was Steel’s 13D filed September 7, 1999. The following March 10, Steel sent a letter announcing an intention to wage a proxy fight, nominating Warren Lichtenstein and two other candidates. UIC quickly compromised, agreeing to nominate Lichtenstein to the board if shareholders voted to increase board membership from six to seven. Moreover, another Steel representative would be allowed to attend as an observer. In return, Steel agreed to a standstill, curtailing additional activism efforts until December 31, 2001.

Steel quickly revived its activism efforts following expiration of the agreement. By February, there were rumors Steel had met with an investment banker regarding finding a buyer for UIC. In March, Steel released a letter stating a desire for two more board seats. In this instance there were no publicly released negotiations. However, UIC did announce the sale of its non-core transportation business on March 28 and revealed ongoing efforts to find a buyer for the entire company on April 8. It is unclear whether UIC would have taken these steps without pressure from Steel Partners.

As UIC delayed its annual meeting from July 2 to October 4, Steel launched its proxy fight in late August. They later reduced the number of desired seats to one. As UIC had cumulative voting, reducing the number of contested seats enhanced the prospects of Steel’s candidate. As with the other affairs, Steel and its target exchanged barbed comments in dueling presses releases. In the end, Steel’s candidate won one of the two seats. However, a different

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UIC director immediately resigned allowing the losing candidate to retain his seat. This move further angered Steel who argued it was additional evidence of UIC’s disregard for shareholder rights. In a subsequent letter they noted:

“The overt manipulation by the controlling members of the Board, under the direction of Mr. Gelb (the Chair), could not have been more evident as when Paul Hoeper was appointed to the Board by the controlling members of the Board immediately following the last annual meeting, even after he lost the election by a stunning margin. Appointing Mr. Hoeper to the Board on the same day he lost the election, obviously a preconceived ploy to entrench the controlling members of the Board, was a slap in the face of the stockholders and constituted blatant disenfranchisement.”

The activism continued the following year with additional letters. Among their many demands, Steel requested a clear CEO succession plan, the sale of non-core assets or the entire company, a recapitalization program involving share repurchases or increased dividends, and cost cuts. The two parties compromised following increasingly acrimonious letter exchanges and the threat of yet another proxy fight. UIC announced Fred Strader would become the new President and CEO. It later announced a shareholder value enhancement program that would close its New York office, step up efforts to sell excess real estate and one division, and consider buying back some shares. Moreover, two affiliated directors resigned allowing the appointment of new independent directors. Finally, Lichtenstein became board chair and a $10 million share repurchase program commenced following the annual meeting.

The subsequent four years were relatively uneventful. The company did successfully submit a proposal to declassify its board at the 2004 annual meeting. Moreover it issued its first long-term debt, a $120 million convertible senior notes private placement, in September 2004.

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25 Letter from Steel Partners to UIC board, dated April 1, 2003 and disclosed in Steel’s April 2, 2003 13D/A filing.
26 Letter from Steel Partners to UIC board, dated July 25, 2003 and disclosed in Steel’s 13D/A filing of the same date.
UIC allocated $25 million of the issue for share repurchases with the balance to be applied to possible acquisitions and general corporate purposes. Also UIC was able to improve profitability with adjusted EBITDA/Total Assets of 10.8% and 3.6% in 2005 and 2006, respectively.

Finally, on October 8, 2007, the company announced it would be acquired by Textron Inc for $81 per share. The total purchase price of $1.1 billion comprised $806.5 million for existing stockholders and the remainder for shares issued to convertible bond holders. The price represented a 7.1% premium over the previous day’s price. Steel tendered its entire stake of 1,935,950 shares. Textron announced a successful conclusion to the offer on November 14.

The investment, activism, and ultimate sale of the company were extremely profitable for Steel. Steel had already sold 141,100 shares for $7,623,425 in March 2006. Between that sale and the Textron tender offer, Steel grossed a total of $164,435,375 representing a nice return on its original aggregate investment of $33,348,245, including commissions.

5. Synthesis and correspondence to broader hedge fund activism studies

A common factor of the cases is Steel’s focus on governance issues, particularly general board entrenchment exacerbated by the existence of a staggered board. However, it is notable that Steel used the desired governance changes primarily as a means towards bigger goals such as encouraging the sale of the company or facilitating a reduction in costs and compensation. The relative unimportance of effecting governance changes is consistent with Brav et al (2008) who report insignificant announcement effects for activism with a governance focus.

The target management response varied. Ronson’s board was willing to meet with Steel’s representatives in the beginning, but quickly rebuffed all Steel efforts to communicate or

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negotiate. While this attitude allowed them to retain their independence, it came at the expense of a time consuming lawsuit and languishing share price. In contrast, from the outside, it appears that BKF refused to meet with Steel’s representatives until threatened with a proxy fight and a concerted wolf-pack effort. By then it was too late, and Steel was able to handily win its proxy fight. UIC took the middle road, securing a stand-still agreement in exchange for allowing Lichtenstein a board seat. While it bought peace for awhile, Steel’s patience and persistence eventually won the day with an additional board seat, the Chair position for Lichtenstein, and the eventual sale of the company to Textron. Brav et al. (2008) reports a varied target response to activist demands with fight/resist being the most common response (41.3%) of the cases. Other responses comprise negotiate (29.1%) and accommodate (29.7%). The decision to fight was positively correlated to the perceived hostility of the hedge fund’s efforts.

Brav et al. (2008) define a successful activism campaign as one in which the target management at least partially agrees to make the desired changes. However, as can be seen in the BKF case, success in outcome does not ensure profitability. Moreover, Brav et al. stress that the activist efforts are not short term (as much as 22 months, on average). Even so, given the duration of the Ronson and UIC campaigns, the time frames employed by Brav et al. (12 months), Greenwood and Schor (2009) (18 months), and Clifford (2007) (36 months) to measure performance might be revisited. While, UIC earned a handsome return in the short term, Steel’s investment continued to provide great returns over many years. On the flip side, impatience and quick tactical success, as with BKF, might lead to disaster. In the end, current metrics used to measure success are incomplete.

Steel’s experience with their three targets corresponds with the broader evidence of Greenwood and Schor (2009) who report targets that are eventually acquired earn average
abnormal returns of 25.85% over the 18 months after filing. Non-target firms earn insignificant abnormal returns. However, it should be noted that UIC was experiencing a fairly steady run up in its share price even before the Textron offer.

Of the targets, Ronson might be seen as the one where management was most successful. That is, they kept their independence and did not make any compromises. Even so, Ronson’s share returns have been poor for a decade, so the success must be deemed relative. In the case of BKF, management ignored or rejected many overtures from Steel Partners and other activists. Then they attempted to compromise with the activists when faced with a concerted effort. However, by this time, the activists were determined to carry all before them and saw the attempted compromise as a sign of weakness. One important difference between the two targets is the shareholdings of the officers and directors. Ronson’s controlled a significant stake, which they later augmented by “bribing” another large shareholder to trade his voting rights for a consulting agreement.

Another difference between the two cases is when they were initiated. Steel first approached Ronson in 1997 and BKF in 2004. Over time, the hedge fund activists have generally become more vocal and determined. In the case of BKF, Steel had the advantage of working in a wolf pack. Working in this fashion gave the activists a louder voice and a greater number of shares under control. Moreover, BKF’s market capitalization at the initiation of the campaign was nearly 27 times larger than Ronson’s. All of these differences are suggestive of a trend towards greater power and reach on the part of hedge fund activists.

In contrast, the UIC campaign can be considered a success both in terms of returns and outcomes. In August 2003, near the end of the fourth year of Steel’s effort, it obtained a significant goal, a second seat on the board of directors with Lichtenstein becoming Chair shortly
thereafter. At this point, UIC’s abnormal buy-and-hold return was already 117%. However, this was just the beginning with the abnormal buy-and-hold return reaching 304% by the end of year six.

Events surrounding the three activism efforts are consistent with Steel’s other efforts. Steel has filed 63 initial 13D forms over the period 1995 to 2006. For this group, Steel’s average (median) holding period is 36 (20) months, with a quarter of the sample at 48 months or more. The holding periods when Steel publicly releases the goal of its activism are especially lengthy. For example, Steel’s mean holding period exceeds 55 months when it pushed for the removal of a takeover defense (13 cases) or the sale of the company or one of its divisions (15 cases) and averaged 50 months when it desired board seats (28 cases). In contrast, the mean holding period is only 24.6 months when the only evidence of activism was boilerplate language in Item 4 of the 13D statement (29 cases). Coupled with the results of Greenwood and Schor (2009), these results support the idea that future activism studies should examine longer holding periods.

Steel’s success rates are similar to those reported by Brav et. al. (2008). For example, in the fifteen cases where the goal was sale of the company or a divestiture, the event occurred ten times. Likewise, Steel was able to obtain a board seat in 22 out of 28 attempts. Even so, the abnormal buy-and-hold returns obtained by Steel typically are insignificantly different from zero even when segmenting the sample by activism goal or activism success.31 This lack of significance is consistent with the mixed results indicated by Steel’s experiences at BKF and UIC. Namely a successful activism campaign does not guarantee a successful investment. However, the lack of results might be driven by the relatively small sample size, especially for the longer windows.

31 The one exception is the abnormal buy-and-hold returns of 47.02% for months 1 to 48 are significantly different from zero at the 8.8% level (n = 12).
6. Conclusion

Our cases suggest the following points. For managers and boards wishing to maintain their independence, the lesson is to be to dig in and refuse to negotiate, preferably while maintaining a big ownership stake. However, forcing the activist to go hostile might not be a great idea as it might lead to a lawsuit or an insatiable wolf-pack type campaign. For the activists, patience can be a virtue. However, do not let the desire for “success” come at the expense of profitability. Success was achieved at BKF and was probably a quixotic venture at Ronson. In both cases, Steel Partners lost a great deal of money and experienced opportunity costs.

Greenwood and Schor (2009) note in passing the interesting phenomenon that in 15.7% of their observations the activism might have had unintended, but possibly profitable consequences. That is, the acquisitions end point (acquisition of target) is different from the original goal (improve corporate governance). This result, coupled with the implications of our study, suggest the definition of a “successful” campaign remains elusive.
References


Table 1. Description of the financial characteristics at target firms prior to activism
Total assets and market capitalization are millions of dollars. n.r. is not reported.

<table>
<thead>
<tr>
<th></th>
<th>Ronson</th>
<th></th>
<th>UIC</th>
<th></th>
<th>BKF</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total assets</td>
<td>13.40</td>
<td></td>
<td></td>
<td>184.45</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Market Capitalization</td>
<td>6.16</td>
<td></td>
<td></td>
<td>89.29</td>
<td></td>
<td></td>
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<tr>
<td>Gross Margin</td>
<td>0.317</td>
<td>-0.036</td>
<td>0.294</td>
<td>-0.009</td>
<td>0.058</td>
<td>-0.289</td>
</tr>
<tr>
<td>Profit Margin</td>
<td>0.024</td>
<td>-0.004</td>
<td>0.064</td>
<td>-0.006</td>
<td>-0.082</td>
<td>-0.444</td>
</tr>
<tr>
<td>EBITDA to assets</td>
<td>0.153</td>
<td>0.094</td>
<td>0.098</td>
<td>-0.023</td>
<td>0.037</td>
<td>-0.219</td>
</tr>
<tr>
<td>Return on Assets</td>
<td>0.048</td>
<td>0.010</td>
<td>0.070</td>
<td>0.024</td>
<td>-0.052</td>
<td>-0.213</td>
</tr>
<tr>
<td>Cash to assets</td>
<td>0.005</td>
<td>-0.117</td>
<td>0.140</td>
<td>0.115</td>
<td>0.234</td>
<td>-0.086</td>
</tr>
<tr>
<td>Current ratio</td>
<td>1.019</td>
<td>-1.232</td>
<td>2.398</td>
<td>-0.315</td>
<td>n.r.</td>
<td>n.r.</td>
</tr>
<tr>
<td>Long-term debt ratio</td>
<td>0.132</td>
<td>0.083</td>
<td>0.000</td>
<td>-0.125</td>
<td>0.000</td>
<td>-0.078</td>
</tr>
<tr>
<td>Total debt ratio</td>
<td>0.848</td>
<td>0.438</td>
<td>0.407</td>
<td>-0.163</td>
<td>0.425</td>
<td>0.048</td>
</tr>
<tr>
<td>Fiscal Year</td>
<td>1995</td>
<td>1998</td>
<td>2003</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Event/Characteristic</td>
<td>Ronson</td>
<td>UIC</td>
<td>BKF</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>----------------------------------------------------------</td>
<td>--------------</td>
<td>--------------</td>
<td>--------------</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Panel A: Governance prior to Date of Proxy</td>
<td>October 20, 1995</td>
<td>March 25, 1999</td>
<td>April 16, 2003</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CEO Ownership</td>
<td>39.9%(^a)</td>
<td>3.6%</td>
<td>9.2%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Officer &amp; Director Ownership</td>
<td>33.0%(^a)</td>
<td>7.7%</td>
<td>11.5%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other 5% ownership (total)</td>
<td>12.8%</td>
<td>25.8%</td>
<td>34.4%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Board Size</td>
<td>6</td>
<td>6</td>
<td>9</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Insiders</td>
<td>2</td>
<td>2</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Grey directors</td>
<td>2</td>
<td>0</td>
<td>2</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Independent Outsiders</td>
<td>2</td>
<td>4</td>
<td>6</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CEO/Chair same person?</td>
<td>Yes(^b)</td>
<td>No</td>
<td>Yes(^c)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CEO has been director since</td>
<td>1952</td>
<td>1995</td>
<td>1996</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Board Classified?</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

\(^a\) Includes shares held in the Ronson Corporation Retirement Plan. Louis V. Aronson II, the CEO, is a trustee of the plan.

\(^b\) Louis Aronson is the grandson of the company’s founder.

\(^c\) The CEO, John A. Levin, founded the company and its privately held predecessor, John A. Levin & Co, Inc.
<table>
<thead>
<tr>
<th></th>
<th>Ronson</th>
<th>UIC</th>
<th>BKF</th>
</tr>
</thead>
<tbody>
<tr>
<td>First known share acquisition</td>
<td>June 1996</td>
<td>July 1999</td>
<td>March 2004</td>
</tr>
<tr>
<td>First known contact</td>
<td>May 1997</td>
<td>March 2000</td>
<td>before December 2004</td>
</tr>
<tr>
<td>Initial 13D filing</td>
<td>March 1998</td>
<td>September 1999</td>
<td>April 2004</td>
</tr>
<tr>
<td>Stake at time of initial filing</td>
<td>6.0%</td>
<td>6.3%</td>
<td>6.5%</td>
</tr>
<tr>
<td>Peak ownership month</td>
<td>December 1998</td>
<td>October 2007</td>
<td>August 2004</td>
</tr>
<tr>
<td>Peak ownership stake</td>
<td>9.9%</td>
<td>19.6%</td>
<td>9.50%</td>
</tr>
<tr>
<td>Stake at end of public relationship</td>
<td>4.2%</td>
<td>0%</td>
<td>1 share</td>
</tr>
<tr>
<td>Duration of ownership</td>
<td>13 years, 1 month</td>
<td>8 years, 4 months</td>
<td>3 years, 3 months</td>
</tr>
</tbody>
</table>
Table 4. Steel Partners primary concerns or goals at each target firm

<table>
<thead>
<tr>
<th>Ronson</th>
<th>UIC</th>
<th>BKF</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>M&amp;A related</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Focus on core consumer products</td>
<td>Divest non core business</td>
<td>Sale of entire company</td>
</tr>
<tr>
<td>Assessment and possible sale of various divisions of the company</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Governance</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Staggered board</td>
<td>Staggered board</td>
<td>Staggered board</td>
</tr>
<tr>
<td>Separation of Chair and CEO</td>
<td>Chair is insufficiently independent</td>
<td>Poison pill</td>
</tr>
<tr>
<td>Succession plan for older CEO</td>
<td>Succession plan for CEO</td>
<td>Supermajority provisions to approve mergers</td>
</tr>
<tr>
<td>Poison pill</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lack of board independence</td>
<td>Majority of independent outsiders</td>
<td></td>
</tr>
<tr>
<td>General entrenchment</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Cost control</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Excessive compensation for Louis Aronson (LA)</td>
<td>Reduce expenses, particularly the closure of New York office</td>
<td>Fund manager compensation</td>
</tr>
<tr>
<td>General cost cutting</td>
<td>Excessive director compensation</td>
<td>Appoint in Chief Operating Officer to keep general expenses under control</td>
</tr>
<tr>
<td><strong>Other</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sweetheart consulting deals for directors and one large shareholder</td>
<td>Share repurchase</td>
<td>Regular share repurchases</td>
</tr>
<tr>
<td></td>
<td>Improved investor relations department</td>
<td>Increase dividend</td>
</tr>
</tbody>
</table>