ACTIVIST INVESTORS AND IMPLICATIONS FOR CORPORATE GOVERNANCE: A CASE STUDY OF BARINGTON CAPITAL GROUP AND L BRANDS

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OPEN ACCESS

How to cite this paper: Grove, H., & Clouse, M. (2019). Activist investors and implications for corporate governance: A case study of Barington Capital Group and L Brands. *Corporate Board: Role, Duties and Composition, 15*(2), 28-36. https://doi.org/10.22495/cbv15i2art3

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ISSN Online: 2312-2722
ISSN Print: 1810-8601

Received: 25.04.2019
Accepted: 18.06.2019

JEL Classification: G3, G30
DOI: 10.22495/cbv15i2art3

Abstract

The key research question of this paper is to explore the implications for both financial and corporate governance performances from the emergence of activist investors. This paper uses a dramatic case study of one specific activist investor's role, Barington Capital Group, in analyzing the performance of a public company, L Brands, which lost $20 billion in market capitalization in the last three years while the U.S. stock market was going up significantly. In conclusion, this activist investor's approach and recommendations in this case study could be used as operational guidelines by boards of directors and corporate executives for improving both their financial and corporate governance performances. From its financial analysis, Barington recommended either an initial public offering of the superior performing Bath & Body Works brand or a spinoff of the weak performing Victoria's Secret brand. From its corporate governance analysis, Barington recommended that L Brands improve the composition of its board of directors whose deficiencies in director independence, industry experience, and diversity have hindered its ability to effectively oversee and advise management. Accordingly, the major sections of this paper are financial analysis, operational zeitgeist brand analysis, and corporate governance analysis. It is important to note that this paper was prepared exclusively with public information.

Keywords: Activist Investors, Zeitgeist, Corporate Governance, Barington, L Brands

Authors' individual contributions: Conceptualization – H.G. and M.C.; Methodology – H.G.; Resources – M.C.; Writing – Original Draft – H.G.; Writing – Review & Editing – M.C.; Visualization – M.C.; Funding Acquisition – M.C.

1. INTRODUCTION

An activist investor or shareholder uses an equity investment in a corporation to put pressure on its management. Major activist investors include private equity firms, hedge funds, and wealthy individuals. The goals of activist investors have generally been financial to increase shareholder value through changes in corporate policy, financing structure, revenue enhancement, cost cutting, and corporate governance improvements (Kenton, 2018). However, contemporary non-financial goals are emerging, such as sustainability reporting, social responsibility, human rights, environmentally friendly policies, and disinvestment from countries. Activist investor demands are increasing as a total of 922 publicly listed global companies were subjected to activist demands in 2018, up from 856 in 2017 (Activist Insight, 2019).

A small investment in a company of less than 10% may be enough to launch a successful activist campaign. Once criticized as corporate raiders, shareholder activists are now admired for sparking change in corporate boardrooms and leading corporate boards in developing best practices for responding to shareholder activism. Activists increasingly are transitioning from outside agitators to influential insiders. For example, the non-financial form of shareholder activism is affecting companies in a range of areas, such as environmental and social performances. Currently, most of the U.S. S&P 500 companies have publicly disclosed their sustainability performances with Environmental, Social, and Governance (ESG) metrics (Grove & Clouse, 2018). Such companies have outperformed their competitors who did not report such ESG metrics (Verschoor, 2017).

Shareholder activism can take many forms, such as proxy battles, publicity campaigns, shareholder resolutions, litigation, removal of the board of director members, and negotiations with management. Also, "engaged activism" is longer term in focus with correlated benefits to the real economy, as distinct from shorter term "financial activism." Recent engaged activist investment funds include California Public Employees' Retirement System, State Board of Administration of Florida, and Relational Investors. Using the Internet, smaller shareholders have also gained an outlet to voice their opinions. The practice of shareholder activism has its roots in the 17th-century Dutch Republic with pioneering activist shareholders like Issac Le Maire, a sizable shareholder of the Dutch East India Company (Wikipedia, 2019).

The motivation and aim of this paper are to demonstrate the ways an activist investor can influence the corporate governance of a public company and help protect its shareholders. This case study of the activist investor, Barington Capital Group, March 2019 letter to L Brands is an effective, dramatic example of a needed outside perspective since L Brands market capitalization has lost approximately $20 billion over the last three years with one-half of that loss coming in 2018 while the overall U.S. stock markets have gone up significantly over that period. After a literature review of shareholder activism, the following sections of this paper are developed from this case study: financial analysis, operational zeitgeist brand analysis, and corporate governance analysis. Supplemental financial analyses are provided by the research paper authors. The paper then has conclusions for the role of an activist investor in providing recommendations and corporate governance implications. It is important to note that this paper was prepared exclusively with public information.

2. LITERATURE REVIEW OF SHAREHOLDER ACTIVISM

Raja and Kostyuk (2015) outlined shareholder activism development in common law (USA and UK) countries and civil law (Germany and Ukraine) countries. They concluded that the type of legal system was not the chief determinant of shareholder activism. Their comparative analysis showed that the system of domestic corporate regulation, development of the stock market, companies' capitalization, and corporate governance influenced the development of shareholder activism in equal measure. Belcredi, Bozzi, Ciavarella, and Novembre (2017) found that specific classes of institutional investors actively monitored investee firms under concentrated ownership and that Proxy Advisors (PA) performed an informational role as voting by institutional investors was strongly correlated with PA recommendations even though institutional investors did not follow PA recommendations blindly but looked at specific reasons of concern in PA reports.

Esposito De Falco, Cucari, and Sorrentino (2016) looked at 120 firms in three different contexts (Italy, Australia, and USA) between 2012 and 2014. They found that factors affecting dissent depend on the context of analysis. In an insider system context, like Italy, dissent was positively correlated with the concentration of ownership but in an outsider system context, like USA, the variable of remuneration was positively correlated to the dissent. In the Australian context, any variable was significant. Jansson (2014) examined the issue of what motivates shareholder activism. The standard explanation portrayed shareholder activism as a response to poor corporate performance, but the empirical literature had only inconclusive support. As a complementary explanation, this paper found that shareholder activism can also be a response to increasing costs for exiting an investment, making outside shareholders increasingly exposed to expropriation risks. Van der Elst (2011) assessed trends in shareholder activists, how shareholders responded to the fall in profits, and how they exercised influence in the turbulent times between 2007 and 2010 in four European countries after the global economic crisis of 2008. He concluded that shareholder activism depended on the identity of large individual shareholders shedding doubts on the effectiveness of one size fits all (mandatory) corporate governance measures.

None of these research studies investigated the ways activist investors could influence both the financial and corporate governance performances of a public company. This paper goes beyond these circumstances and profiles of activist investors in the current literature. The key research question of this paper is to explore the implications for corporate governance from the emergence of activist investors, using a case study of one specific active investor's role, Barington Capital Group, in analyzing the public company L Brands. It focuses upon the potential impacts and implications for both financial and corporate governance performances from the emergence of activist investors.

3. FINANCIAL ANALYSIS

Barington Capital Group is a fundamental, value-oriented activist investor. It was founded in January 2000 by James Mitarotonda, a former executive at Bloomingdales and Citibank and an experienced public company director with over ten directorships. Barington invests in undervalued publicly traded companies that it believes can appreciate significantly in value as a result of a change in corporate strategy or improvements in operations, capital allocation or corporate governance. Barington's investment team, advisors, and network of industry experts draw upon their extensive strategic operating and boardroom experience to assist companies in designing and implementing initiatives to improve long-term shareholder value. Barington is an influential activist investor, not an outside agitator. For example, it is not even in the top 16 institutional owners of L Brands Inc, which range from Vanguard at 8.8% and BlackRock at 7.0% to Fidelity Management & Research Company at 1.5%.

This activist investor example for L Brands, Inc. is based on Barington's March 5, 2019 eight-page public letter to Leslie Wexner, the Chairman of the Board (COB) and Chief Executive Officer (CEO) of L Brands Inc, asking L Brands to separate its Victoria's Secret brand from its Bath & Body Works brand (Reuters, 2019; Haigh, 2019; McIntyre, 2019). Barington concluded that L Brands has significant value potential that is not being realized. Thus, Barington's public letter shared its recommendations with the COB/CEO on how L Brands can address several current challenges and meaningfully improve its long-term value for shareholders. L Brands with its core brands of Victoria's Secret, PINK, and Bath & Body Works had created value for its shareholders, but the performance of L Brands has been disappointing over the past few years.

As illustrated by Barington's common stock performance analysis in Table 1, the common stocks of L Brands' industry group outperformed L Brands over the last one, three, and five-year periods by 52.0%, 98.7% and 108.4%, respectively. L Brands selected its own peer group per its 2018 Proxy Statement as Abercrombie & Fitch, American Eagle Outfitters, Avon Products, Bed Bath & Beyond, The Estee Lauder Companies, The Gap, JC Penny, Kohl's, NIKE, Nordstrom, Ralph Lauren, Ross Stores, Starbucks, Tapestry, The TJX Companies, and Williams-Sonoma. Also, L Brands' common stock performance was lower than the market as a whole (S&P 500 and Russell 2000 indexes) by a substantial margin over the last one, three, and five-year periods, being negative at 32.1%, 63.1% and 36.7%, respectively, versus positive returns for both major indexes over all three periods. Furthermore, L Brand's common stock price plummeted from an all-time high of $100.22 on November 4, 2015 to $26.81 on March 5, 2019, the date of Barington's letter. It has stayed about the same at $25.31 near the end of April 2019. L Brand's total market capitalization loss has been approximately $20 billion and about half of that loss occurred in 2018.

As illustrated by the valuation ratios analysis in Table 1 (provided by the research paper's authors), L Brands' major valuation ratios, price/earnings, price/sales, and price/cash flow, were less than their S&P 500 benchmarks in 2018, 2017, and 2016, in four out of the nine comparisons. The key valuation ratios for Wall Street of price/earnings and price/sales were less than the S&P 500 benchmarks in the last two-year comparisons of 2018 and 2017. L Brands only did well on the price/cash flows comparisons over the three years.

Table 1. L Brands valuation analysis (12/31/2018)

Valuation Metrics *Common Stock Performance (%)*	*L Brands*	*Industry*	*S&P 500*	*Industry > L Brands*	*Russell 2000*
One Year	-32.1	19.9	6.3	52.0	5.1
Three Year	-63.1	35.6	50	98.7	55.5
Five Year	-36.7	71.7	68.4	108.4	44.7
Valuation Ratios by Year	***2018***	***2017***	***2016***	***S&P 500 Benchmark***	
Price/Earnings Less than Benchmark: 2018, 2017	17.61	16.54	22.71	21.04	
Price/Sales Less than Benchmark: 2018, 2017	1.33	1.50	2.29	2.28	
Price/Cash Flow Greater than Benchmark: All 3 Years	11.99	9.46	13.71	9.23	

To supplement this common stock performance, the research paper authors provided an earnings management financial analysis to see if there are any red flags in L Brands' choice and use of financial accounting methods which might cover up declining financial performance. As shown in Table 2, the well-established fraud or earnings management prediction models (Dechow, Ge, Larson, & Sloan, 2007; Beneish, 1999) and prediction ratios (Dechow et al., 2007; Schilit, 2010; Schilit, Perler, & Engelhart, 2018) are analyzed with their prediction cutoffs. Also, the well-established Altman (2006) bankruptcy prediction model was analyzed since bankruptcy is often the result after poor financial performance initially leads to coverup with fraud or earnings management. Out of the 18 possibilities over the last three years of L Brands' financial performance, there were only three earnings management predictions: the older years of 2017 and 2016 from the Beneish Model and 2016 from the Schilit Quality of Revenues Model with 0.98 which was very close to the no prediction cutoff of 1.0. In summary, there were very few earnings management predictions and no bankruptcy predictions over the three-year period.

Table 2. L Brands earnings management analysis (12/31/2018)

Earnings Management Ratios by Year	*2018*	*2017*	*2016*	*Earnings Management Prediction Benchmark*
Dechow Model Less than Benchmark: All Two Years; No Earnings Mgt.	0.97	0.50	_	>1.0
Beneish Model Greater than Benchmark: 2017, 2016; Earnings Mgt.	-2.10	-1.84	-0.78	>-1.99
Sloan Accrual Ratio Less than Benchmark: All Three Years; No Earnings Mgt.	0.03	0.02	-0.73	>0.10
Schilit Quality of Earnings Ratio Greater than Benchmark: All Three Years; No Earnings Mgt.	1.43	1.72	1.62	<1.0
Schilit Quality of Revenues Ratio Less than Benchmark: 2016; Earnings Mgt.	1.00	1.00	0.98	<1.0
Altman Bankruptcy Model Greater than Benchmark: All Three Years; No Bankruptcy or Earnings Mgt.	3.33	3.87	6.80	<1.80

In Table 3, the research paper authors provided a 2018 competitive analysis of L Brands versus its industry peers and the S&P 500 index. The traditional performance metrics in management effectiveness, financial ratios, profit margins percentages, and growth rate percentages were used. For management effectiveness, the industry outperformed L Brands on every ratio, except income per employee which was slightly less. No return on equity ratios or return on capital ratios could be computed for comparison purposes since L Brands' stockholder equity was always large and negative, indicating inadequate capital for L Brands. It also underperformed the industry on the return on assets ratios for both the one and five-year annual averages while the S&P 500 results were mixed. For the financial ratios, the negative equity meant that both the debt to equity ratio and the leverage ratio (average total assets/average equity) were meaningless and could not be computed. Also, the book value/share was negative. L Brands current and quick ratios had worse performances than the industry. For the profit margin ratios, L Brands did better than its industry peers on gross margins but underperformed on net margins. Pre-tax margins showed mixed results. For all five growth rate percentages, L Brands underperformed its industry peers. It was only better on the 5-year annual dividend average, perhaps trying to retain investors despite its poor financial performances. Based upon its poor stock price performance, this strategy did not work.

Table 3. L Brands competitive analysis (12/31/2018)

Performance Metrics	*L Brands*	*Industry*	*S&P 500*	*Industry > L Brands*
Management Effectiveness				
Return on Equity % 1 Year	n/a	56.58	48.18	n/a
Return on Equity % 5 Year Average	n/a	55.33	20.04	n/a
Return on Assets % 1 Year	9.82	20.64	10.08	10.82
Return on Assets % 5 Year Average	13.90	17.87	8.56	3.97
Return on Capital % 1 Year	n/a	41.89		n/a
Return on Capital % 5 Year Average	n/a	32.94		n/a
Income/Employee	8.24k	8.10k		(0.14k)
Inventory Turnover	4.48	5.22		0.74
Asset Turnover	1.69	2.52		0.83
Financial Ratios				
Debt/Equity Ratio	n/a	0.45		n/a
Current Ratio	1.37	1.61		0.24
Quick Ratio	0.31	0.57		0.26
Leverage Ratio	n/a	2.69		n/a
Book Value/Share	-4.78	6.03		10.81
Profit Margins (%)				
Gross Margin	37.64	30.20		-7.44
Pre-Tax Margin	7.48	10.96		3.48
Net Profit Margin	5.81	8.19		2.38
Average Gross Margin: 5-Year Aver.	41.20	31.18		-10.02
Average Pre-Tax Margin: 5-Year Aver.	13.50	11.70		-1.80
Average Net Profit Margin: 5-Year Aver	9.00	10.00		1.00
Growth Rate (%)				
Revenue Q/Q (Last Year)	6.00	10.77		4.77
Net Income YTD/YTD (last Year)	-15.10	27.28		42.38
Net Income Q/Q (Last Year)	0	18.85		18.85
Revenue: 5 Year Annual Average	3.85	20.04		16.19
Net Income: 5 Year Annual Average	5.50	6.77		1.27
Dividends: 5 Year Annual Average	19.14	7.19		-11.95

4. OPERATIONAL ZEITGEIST BRAND ANALYSIS

Barington attributed L Brands' declining stock price and market capitalization primarily to the disappointing financial performance of the Victoria's Secret brand. In 2015, it was the largest of the two major brands of L Brands versus the Bath & Body Works brand. By 2018, the two brands had reversed positions. From operating income of $1.4 billion in fiscal 2015, Victoria's Secret operating income fell to $500 million in fiscal 2018, a staggering reduction of $900 million, or 64%, in just three years. Its EBITDA margins have similarly declined from over 20% in fiscal 2015 to 15% in fiscal 2018, a 25% erosion. In contrast, Bath & Body Works' operating income of $858 million in 2015 has grown to $1.1 billion in 2018, which is an increase of 28%, to become the company's largest brand.

Barington believed the Victoria's Secret declining performance was primarily due to merchandising missteps and the failure to maintain a compelling brand image that resonates with its target consumers. Victoria's Secret has fallen on hard times, finding itself out of touch with the current zeitgeist that is centered in the #MeToo era on female empowerment (Wahba, 2019). Zeitgeist is defined as the spirit of the times or the spirit characteristic of an age or generation.

Target customers for Victoria's Secret are the Millennial and Gen Z generations so it should be paying attention to zeitgeist. Millennials reached young adulthood around the year 2000 and Generation Z consists of those born in 1995 or later. Gen Z is the largest percentage of the U.S. population at 26% and by 2020, they will account for one-third of the U.S. population. For marketing purposes, Gen Z have lower attention spans, have higher expectations, and are 25% more likely to be addicted to their digital devices than Millennials (Beall, 2016). Gen Z expect businesses, brands, and retailers to be loyal to them. If they don't feel appreciated, they're going to move on. Diversity is also an expectation of Gen Z. Since Gen Z are constantly on their phones or devices and not watching as much live TV, businesses may experience a massive shift in advertising methods and marketing messages. For example, Apparel brands looking to connect with Gen Z have tried embracing edgier brand ambassadors, a departure from prior times when consumer companies tried to avoid politics. Gen Z wants corporations to take a stand on issues, with over 40 percent saying they would pay more for a product if they knew the company was promoting gender equality issues or racial justice initiatives. For an example of this latter issue, Nike released an ad in 2018 featuring controversial Colin Kaepernick and these ads have helped boost sales (Giammona, Wilson, & Ponczek, 2019).

A retail analyst wrote about the death of retail stocks as consumers hoard both time and money. Retailing used to be a leisure activity in the 20th century but not so in the 21st century. With most adult women now in the workforce, fewer consumers shop. They buy or stay home, either going out with a list or shopping online in stores that never close. A common theme from consumers is to save not just money but time, too. The growth of strip malls, where people can drive right up to the entrance, as opposed to shopping malls with hundreds of retailers having long crowded aisles of merchandise, is part of the evolution from consuming as a lifestyle to consuming as a chore (Blankenhorn, 2019).

Some of L Brands' competitors have been responding to such zeitgeist. For example, Nordstrom now has appointment retailing clerks who become stylists for their customers with the right merchandise ready when they come in. Kohl's helps people combine trips with a focus on strip malls. Target combines online ordering with pickup. Other competitors have not been responding to such zeitgeist. JC Penny has wide aisles filled by a variety of goods which invites a long, not a short, visit and is planning to close 27 stores in 2019 after closing 8 in 2018 and 138 in 2017 (Calfas, 2019). Abercrombie & Fitch, a previous L Brands' spinoff, has the following store closes: 40 in 2019, 60 in 2018, 54 in 2017 and over 400 since 2010 (Hanbury, 2019). Gap is planning to close 230 stores in 2019 and 2020. More than 300 store closures were announced in a single day as the retail apocalypse ripped through JC Penny, Gap and Victoria's Secret (Peterson, 2019). Sears closings of hundreds of stores and near bankruptcy in 2019 is another example of this retail apocalypse. Gap is also planning to spin off its Old Navy brand, like Barington's recommendation for L Brands to spin off its Victoria's Secret brand. Like its competitors, L Brands is planning to close 53 Victoria's Secret stores in 2019 after closing 30 stores in 2018 and 15 stores in 2017 (Levisohn, 2019; White, 2019).

Barrington noted several major merchandising mistakes by Victoria's Secret, i.e. not paying attention to zeitgeist. It was slow to adjust to the shift in market demand from padded and push-up bras toward bralettes and sports bras. It has failed to fully capitalize on the tremendous boom in activewear that has been a driver of outstanding performance by Lululemon and other athleisure clothing brands in recent years. Barington observed that women are increasingly being drawn toward brands that promote diversity, inclusivity, and body positivity. However, when asked if Victoria's Secret felt the need to address the market's shift toward diversity and inclusion, such as by putting transgender or plus-size models in its advertisements, L Brands' Chief Marketing Officer responded: "We market to who we sell to, and we don't market to the whole world" (Barington, 2019). This non-zeitgeist marketing strategy was just repeated in March 2019 as Victoria's Secret re-introduced its swimwear line after terminating it three years ago. Advertising for the new swimwear line featured eight white Supermodels. The largest swimwear size currently available (and not in every size) was an XL or 38DD. Social media responded with concerns about a lack of sizing and higher price points.

Despite these issues, Barington noted that Victoria's Secret and PINK are still market-leading brands with store productivity higher than most of its peers. However, even leading brands must evolve to meet their customers' changing demands or risk suffering declining profits and a loss of market share. Barington recommended that L Brands take swift action to improve the performance of Victoria's Secret by correcting past merchandising mistakes and communicating a compelling, up-to-date brand image that resonates with today's consumers, i.e., the zeitgeist problem. For example, L Brands should investigate the zeitgeist problem for the Millennial generation. There are many complex reasons why Millennials preferences differ from prior generations, including less financial stability and memories of growing up during the great recession caused by the 2008 financial crisis, which has led to the term "psychologically scarred Millennials." Accordingly, Millennials are killing many products, services, and industries, such as beer, napkins, cereal, golf, department stores, and designer brands (Taylor, 2017).

Concerning designer brands, like Victoria's Secret swimwear featured with Supermodels, shouldn't L Brands be aware of these Millennial behaviors when re-introducing this product line? It does not seem to fit with either the Millennial or the Gen Z generations or especially the baby boomer generation who are too old for such a product line, i.e. the zeitgeist problem. Per Barington's letter to the L Brands CEO, women are increasingly being drawn toward brands that promote diversity, inclusivity, and body positivity. Also, the Chief Marketing Officer (CMO) of L Brands has done a poor job of stewarding Victoria's Secret brand by failing to communicate a compelling, up-to-date image that resonates with today's consumers. As the CMO himself has said, the key to survival in the fashion industry is for a brand to reinvent itself as its shoppers evolve – not so with this March 2019 re-introduction of the traditional Victoria's Secret swimwear line! Barington concluded that the Victoria's Secret brand image is starting to appear to many as being outdated and even a bit "tone deaf" by failing to be aligned with women's evolving attitudes toward beauty, diversity, and inclusion.

5. CORPORATE GOVERNANCE ANALYSIS

The public Barington letter to the L Brand CEO recommended that his dual roles as Chairman of the Board (COB) and CEO be held by separate individuals to improve corporate governance and operating execution. In another example, ISS and Glass Lewis, proxy advisers, are pushing Boeing to separate the CEO and COB roles after the two fatal crashes of its 737 Max airplanes. They argue that separation of these roles eliminates the conflict of interest that inevitably occurs when a CEO is responsible for self-oversight (Thomas, 2019). This duality problem is slowly being overcome in European Union public companies where over 50% have separated these two roles and in the U.S where about 30% have separated such jobs.

The Barington letter to the L Brands CEO does not politely mention that he has been the only CEO since he founded L Brands in 1963, or 56 years ago. He has had the dual positions of CEO and COB for 50 years and is now 80 years old. How can he deal effectively with the zeitgeist problem? His children would be Gen X, his grandchildren would be Millennials, and his great-grandchildren would be Gen Z! The twelve L Brand board of directors have similar zeitgeist problems as their average age is 70 years old, and none of them have fashion retail backgrounds or experience.

Also, not in the Barington letter, in 2018 the Korn Ferry consulting firm surveyed 795 investors and analysts from 18 global markets which included people from firms having at least $1 billion in assets under management. About two-thirds of the top 400 money managers by asset size took part in this survey. 67 percent of all the survey participants believed that today's CEOs are not fit to handle tomorrow's tasks. They felt that most leaders can't make decisions and take smart actions quickly enough, motivate people effectively, or build trust – all of which are needed to ensure their organization's survival into the future. A Korn Ferry global solution leader recommended that to maintain investor confidence and prepare for future challenges: "Executives need to be a little more disruptive. Energize, manage information flow, let people have a place to be heard. There is a theme of care, positivity, and optimism that these leaders bring when they are doing it right" (Ossinger, 2019).

Jim Chanos, the billionaire short seller, has a corporate governance red flag in deciding whether to short a stock: many senior executives leave the company over a short period of time, inferring company survival problems. Barington noted that L Brands had endured multiple, recent changes to its senior management team. The woman who successfully ran the Victoria's Secret brand for ten years resigned as Victoria's Secret CEO in February 2016. L Brands appointed a new CEO of Victoria's Secret Lingerie in May 2016, only to have her resign in November 2018. During the last three years, numerous other senior executives have departed Victoria's Secret. For a dramatic example of senior executive turnover, when the CEO of Enron, Jeffrey Skilling, un-expectantly resigned, Chanos said that was a huge corporate governance red flag for shorting the stock, observing that Skilling's departure was "like a rat leaving a sinking ship" (Chanos, 2017).

A typical ethical red flag is insider stock sales. For example, three top Equifax executives sold stock after its massive data hack was discovered in 2017 but before it was publicly disclosed. This Equifax insider trading is now the focus of a U.S. criminal investigation (La Monica, 2017). The CEOs of both Enron and Qwest went to jail for illegal insider trading as did the CFO of Enron. The CFO of L Brands sold 50,000 shares for $2,075,878 in two transactions in mid-March 2018. A CFO selling shares is a typical red flag since he/she is the most knowledgeable executive about a company's financial performance and problems. Also, one L Brands board member sold 6,385 shares worth $180,877 on November 21, 2018, just before the end of L Brands' most recent fiscal year.

Barington did have significant concerns about the L Brands board being weak. It observed that the board lacked the composition and independence necessary to perform its oversight functions on behalf of shareholders. Barington also believed that the board lacked directors with a diversity of backgrounds, skills, and perspectives sufficient to meet the strategic needs of the company and ensure that it remains competitive in today's challenging marketplace. Although L Brands had self-determined that eight of its twelve directors were independent per the New York Stock Exchange limited standards, Barington found a majority of these directors had strong ties to the CEO Wexner, to his wife, and to each other through the Columbus, Ohio community where the company has always been headquartered for 56 years. The board also had ties to The Ohio State University in Columbus, which is home to the Wexner Center for the Arts and the Wexner Medical Center. Barington commented that the existence of these business and social relationships raised serious questions as to the true independence of these directors. Furthermore, three of these so-called "independent" directors have a lengthy average tenure of 36 years, which raised concerns about their actual independence.

Barington said that the diversity of the L Brands board needed meaningful improvement. Even though the company's products cater primarily to women, nine of the twelve board members were men. The board also had limited age diversity with the average age of the directors being 70 and the median being 71, which is a concern as the company is currently having zeitgeist challenges connecting with younger customers for its Victoria's Secret brand. Furthermore, the board lacked directors with a recent operating background in fashion branded products that cater to women. As a result, Barington believed that a more diverse board in terms of age, gender, and professional experience would be more effective in providing advice to the management team and ensuring that important strategic and operating decisions are soundly made. Thus, Barington recommended that the effectiveness of the board would be greatly enhanced if it looked outside of its current members' personal and professional networks to identify new director candidates.

Barington recommended that the board consider replacing the CEO's business advisor, the

CEO's wife, who was on the board with no fashion business experience, and all directors with tenure greater than 30 years and recruit new directors from outside of the Columbus, Ohio community. Such new board directors would help to improve gender and age diversity on the board and add valuable experience in fashion retail merchandising, marketing, and international business development. As a frequent activist investor in retail and apparel companies, Barington offered to recommend a number of highly qualified individuals who would help improve the composition and diversity of the L Brands board. To improve corporate governance and operating execution, Barington recommended the company have annual re-elections of the entire board, not just three out of 12 directors each year, and separate the CEO and COB roles.

In another 2016 example of similar duality, independence, diversity, and age problems resulting in weak corporate governance, Volkswagen destroyed $43 billion in market capitalization in just one year after the emission-cheating scandal was disclosed. This one-year destruction negated the prior three-year market cap increase of $44 billion. The Volkswagen CEO had traditionally also been the COB, and Volkswagen's board had nine of its 20 directors (or 45%) who were non-independent as they were or had been Volkswagen executives and they were older white males. If Volkswagen board's union members, dependent on Volkswagen jobs, and Volkswagen board's local government officials, dependent on the economic success of Volkswagen with its headquarters in their city, are also included, then there were 14 of 20 (or 70%) non-independent directors. Accordingly, a corporate governance analyst described the Volkswagen board: "Outside views rarely penetrate. It's an echo chamber" (Stewart, 2015).

6. CONCLUSIONS

The key research question of this paper is to explore the implications for both financial and corporate governance performances from the emergence of activist investors. This paper uses a case study of one specific active investor's role, Barington Capital Group, in analyzing the public company, L Brands. In conclusion, this activist investor's approach and recommendations in this case study could be used as operational guidelines by boards of directors and corporate executives for improving both their financial and corporate governance performances. From its financial analysis, Barington recommended that L Brands board of directors retain a financial advisor to help explore opportunities to improve its financial market value. It advocated either an initial public offering of the superior performing Bath & Body Works brand or a spinoff of the weak performing Victoria's Secret brand. Demonstrating how an active investor can influence the corporate governance of public companies, Barington recommended that L Brands improve the composition of its board of directors after finding a lack of director independence, insufficient industry experience, and inadequate diversity. Such problems have hindered the L Brand's board of directors' ability to effectively oversee and advise management, especially since $20 billion of L Brand's market capitalization has been destroyed in the last three years while the overall U.S. stock market has been increasing.

The limits of this research study focus on it just being a case study of one activist investor's analysis of one public company. Future corporate governance research could involve comparative field studies of publicly held companies by activist investors for their financial and corporate governance analyses to determine more general conclusions about the role of activist investors. Also, follow-up field studies could investigate whether companies have corrected their well-publicized board of directors' problems, such as the 2016 Volkswagen board, or the 2017 Equifax board, or the 2019 L Brands board, and if so, specify the lessons learned.

Barington had the following financial recommendations for L Brands. It concluded that while the financial performance of the Victoria's Secret brand over the past three years has been concerning, the performance of the Bath & Body Works brand has been exceptional. Bath & Body Works operating income has grown from $858 million in fiscal 2015 to $1.08 billion in fiscal 2018, an increase of 126%. This brand generates industry-leading EBITDA margins of about 25% and has delivered strong same store sales growth of 5% or more in each of the last five years with 11% comparable sales growth in fiscal 2018. Unfortunately, the stock market did not appear to be ascribing appropriate value to Bath & Body Works' solid financial performance, most likely because it is being overshadowed by the struggles of L Brands' more visible Victoria's Secret brand.

Barington concluded that both the Bath & Body Works and Victoria's Secret brands have the hallmarks to be successful stand-alone publicly traded companies. Bath & Body Works is well positioned in attractive high-margin categories which lend themselves to repeat purchases. Victoria's Secret is an iconic brand with the potential to reignite sales growth and expand margins by reestablishing its customer connections. Each brand has substantial e-commerce operations which could facilitate reaching zeitgeist customers through multiple channels of distribution. It could also facilitate a growing international business, which could one day surpass domestic business in sales. Barington recommended that the board retain a financial advisor to help explore opportunities to unlock the tremendous value of Bath & Body Works by either a spinoff of Victoria's Secret or an initial public offering of Bath & Body Works. Barington believed that either type of transaction would not only facilitate the stock market more appropriately valuing each brand, but it would also enhance the financial performance of each brand by helping improve its strategic focus. Such equity transactions would also help alleviate L Brands' undercapitalization problems. In response to Barington's letter, L Brands said it welcomed open communication with shareholders and valued input that may advance its goal of enhancing shareholder value, but it has taken no specific actions in response to that letter (Reuters, 2019).

Barington's corporate governance recommendations for L Brands demonstrate ongoing corporate governance issues and challenges. Its approach and recommendations can also portray the ways active investors could influence the corporate governance of public companies. Barington recommended that L Brands improve the composition of its board of directors. The L Brands board has the typical corporate governance problem of board entrenchment. Only four of the twelve directors are elected each year. Barington recommended annual re-elections of all board members since it was recommending that a majority of L Brand board members be immediately removed. The New York Stock exchange, where L Brands is listed, requires an independent audit committee of the board of directors with at least one financial expert. None of its four audit committee members have a CPA or appear to have financial accounting literacy. Also, their ages (60, 79, 81, and 85) would indicate a lack of familiarity with current financial accounting principles and regulations. In summary, these audit committee members appear to have the same board independence and age problems, as does the full board of directors.

As an activist investor with the benefits of an independent, external perspective, Barington's corporate governance recommendations are consistent with well-established corporate governance research findings, such as the Grove, Patelli, Victoravich, and Xu (2011) research paper. This paper found that CEO duality was negatively associated with financial performance of U.S. banks leading up to the 2008 financial crisis. This finding is consistent with Barington's recommendation for L Brands to split the CEO and COB jobs, especially since this duality has been going on for 50 years. This paper found that a proportion of directors greater than 70 years old led to poor bank financial performance, again consistent with Barington's recommendation for a younger L Brands board. The paper also found that the frequency of board meetings was positively associated with bank performance while L Brands board only had five meetings last year. Just like the 2011 research paper linked corporate governance weaknesses to banks' poor financial performance, Barington found that L Brands' corporate governance weaknesses helped contribute to its poor financial performance, its poor common stock price performance, and its poor competitive performance. Such an activist investor's methodology could be used as lessons learned by other companies to improve their financial and corporate governance performances.

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