

Hedge Fund Activism and Shareholder Value: Long Term v. Short Term

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(Based on research papers coauthored with Lucian A. Bebchuk, Alon Brav,
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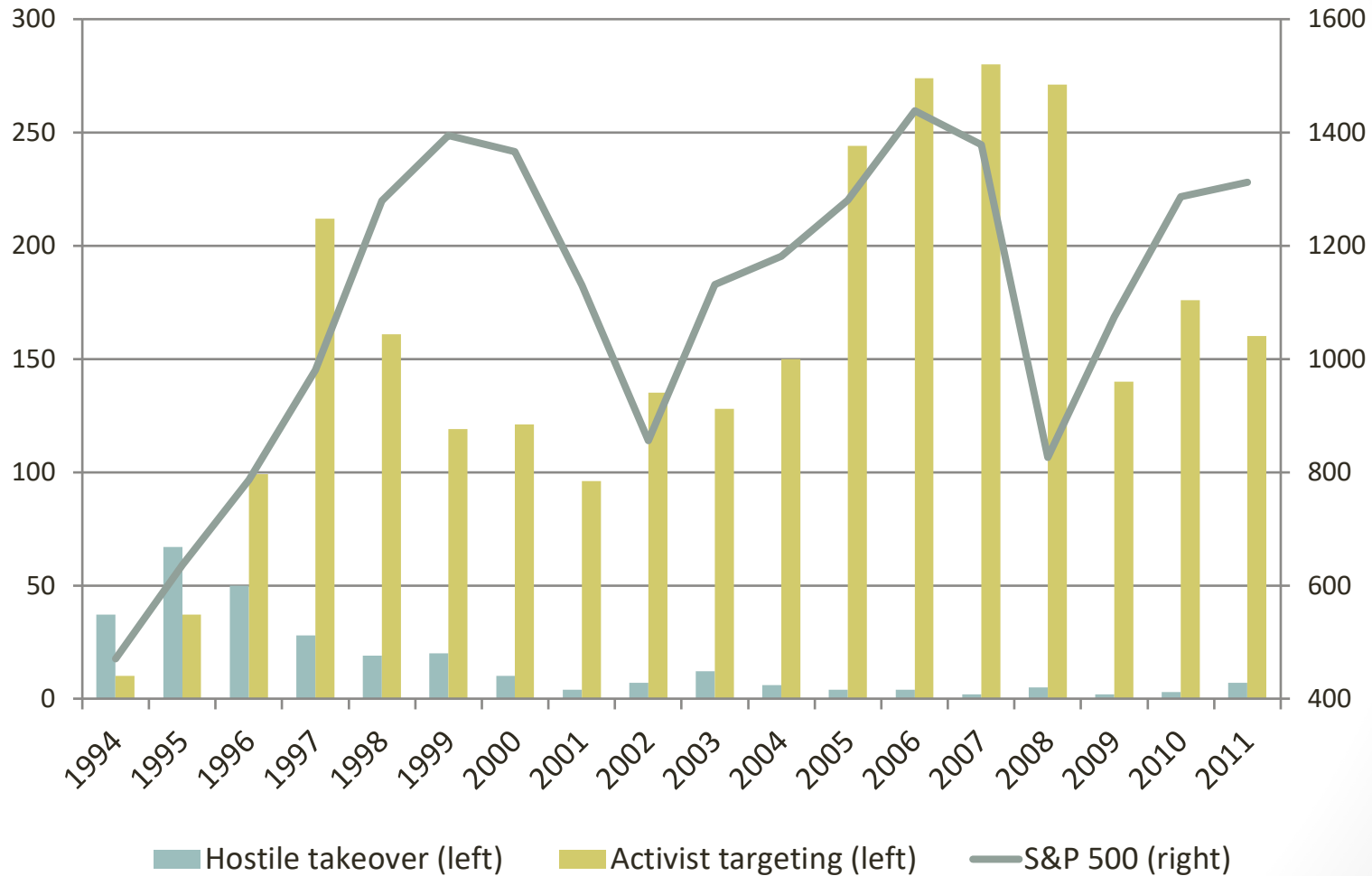
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Hedge fund activism and corporate governance

- Internal governance: boards, executive compensation...
- Watchdogs: auditors, regulators, rating agency...
- Ultimately, there is market discipline--the market for corporate control.
- Hedge fund activism represents a middle ground between internal and external governance.
 - Sizable but strictly minority stakes, typically 5-10%.
 - Not enough to dictate corporate policy, but enough stake to advocate change.
 - Support from fellow shareholders is important.
 - More for influence rather than control.

The landscape

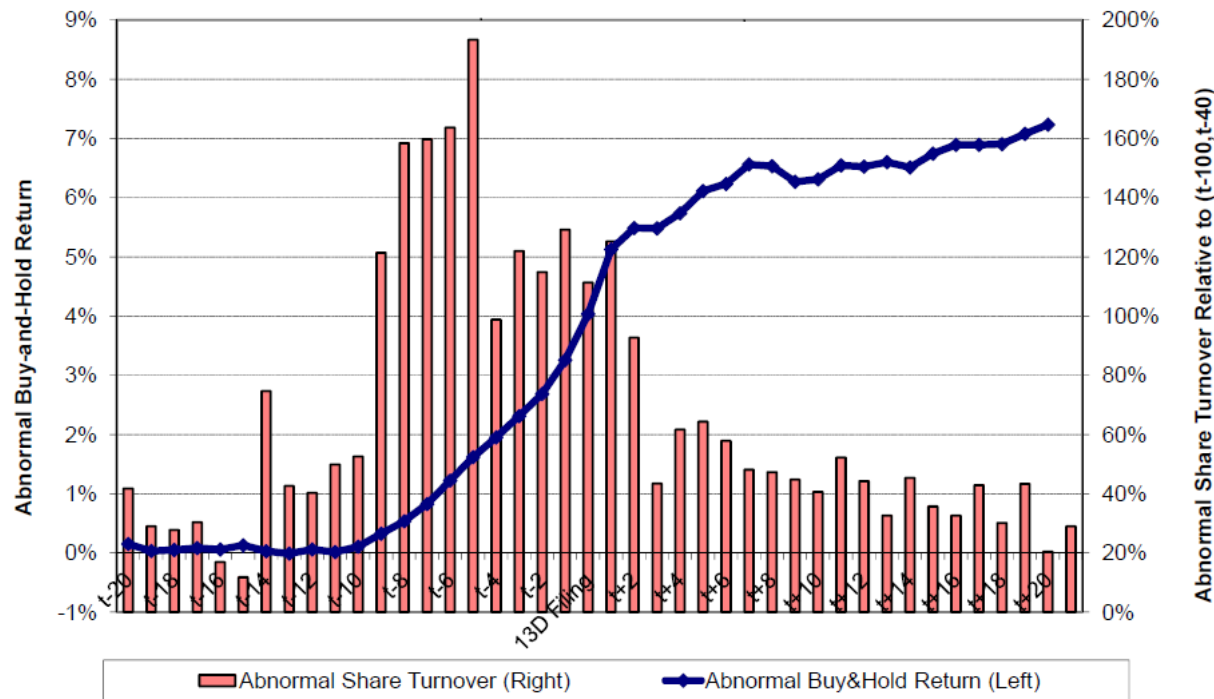


How are hedge funds different?

- Traditional institutional investors (mutual and pension funds):
 - Incidental and ex post.
 - To contain damage.
 - "Wall Street Walk" to avoid underperformers.
- Hedge funds:
 - Strategic and ex ante.
 - To make a profit.
 - Seek investment opportunities in underperformers.
- Defensive vs. offensive activism.

Summary of current academic studies

- The stock market welcomes the news of activist hedge fund engagement.



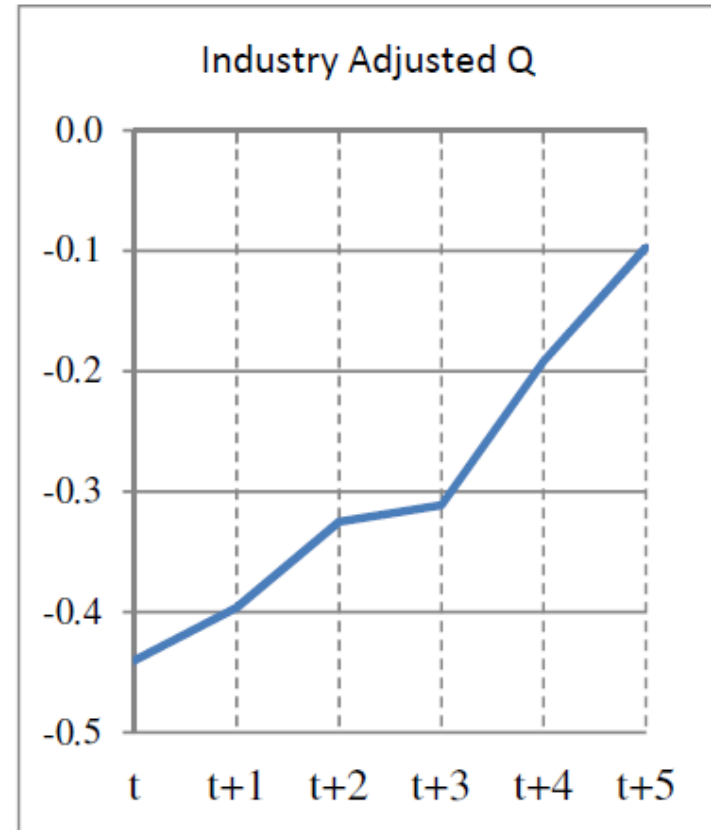
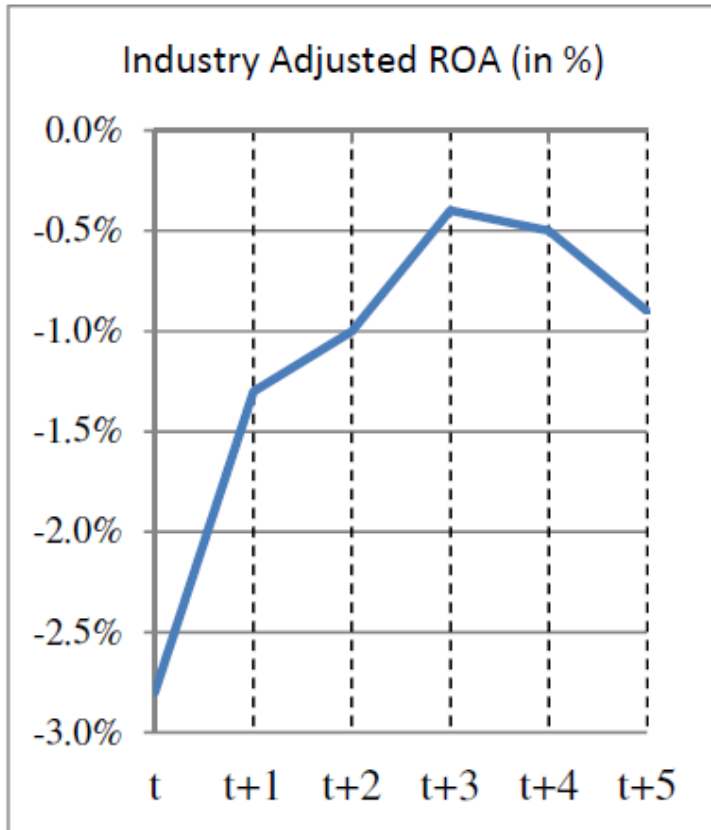
Source: Brav, Jiang, Partnoy, and Thomas (2008)

- Additional evidence: ROA, productivity, dividends, and CEO turnover increase; investment, CEO compensation, and takeover defenses decrease.

Common criticisms

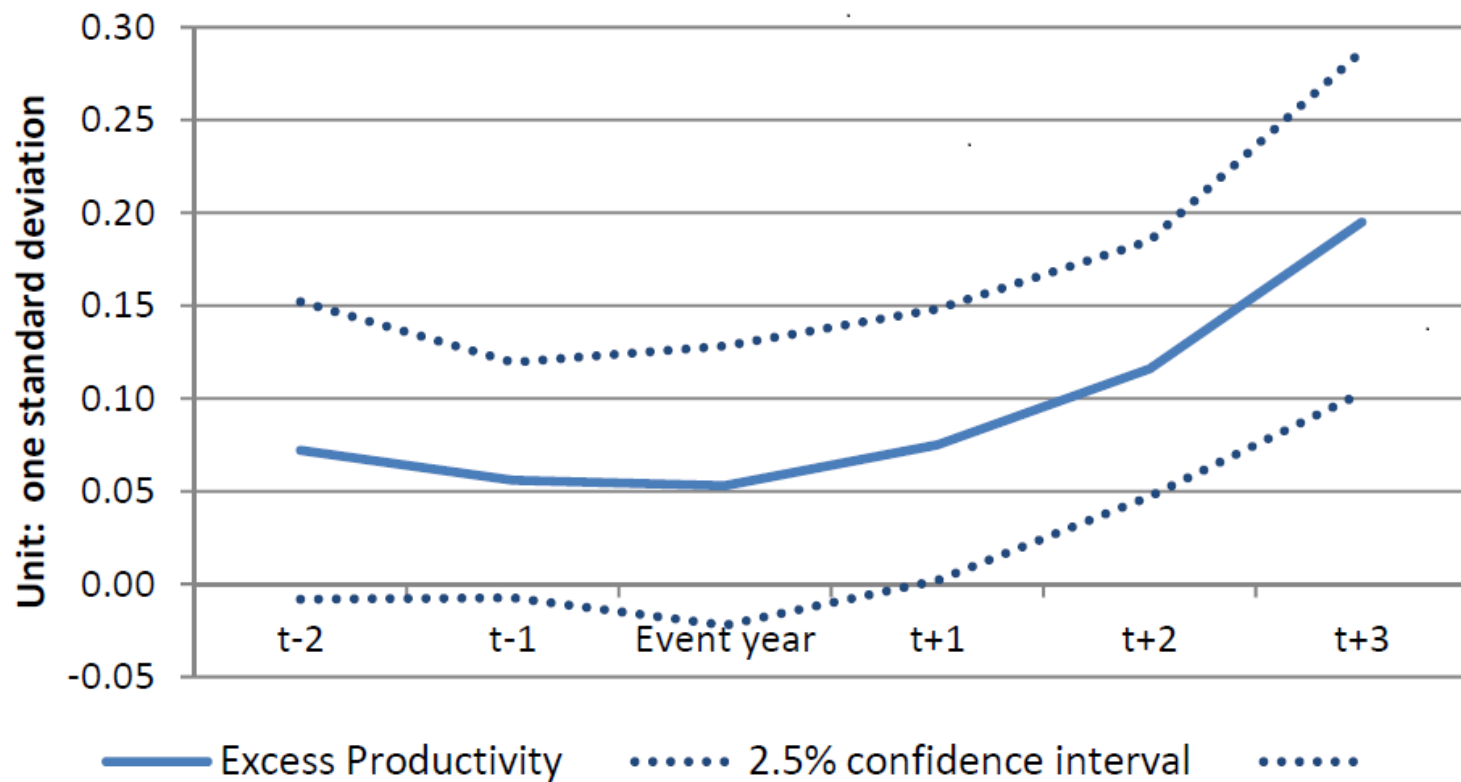
- Hedge funds are "short-termists."
 - Relatively short-term holdings. The median duration is about two years.
 - Often times outcome involves “squeezing” cash out of a target.
 - “Attacks” on some of the most successful, visionary companies.
- What they do is merely "financial engineering" or even "cosmetics."
- They may just be smart stock pickers.
- The first two require some form of market inefficiency; the last one represents the usual "identification" challenge.

If five years are “long term:” Evolution of ROA and Q post targeting



“Real” change: productivity

About 1/3 of the targets are manufacturers with factory level data covered by the U.S. Census Bureau. (benchmark: same industry-year non-event observations)

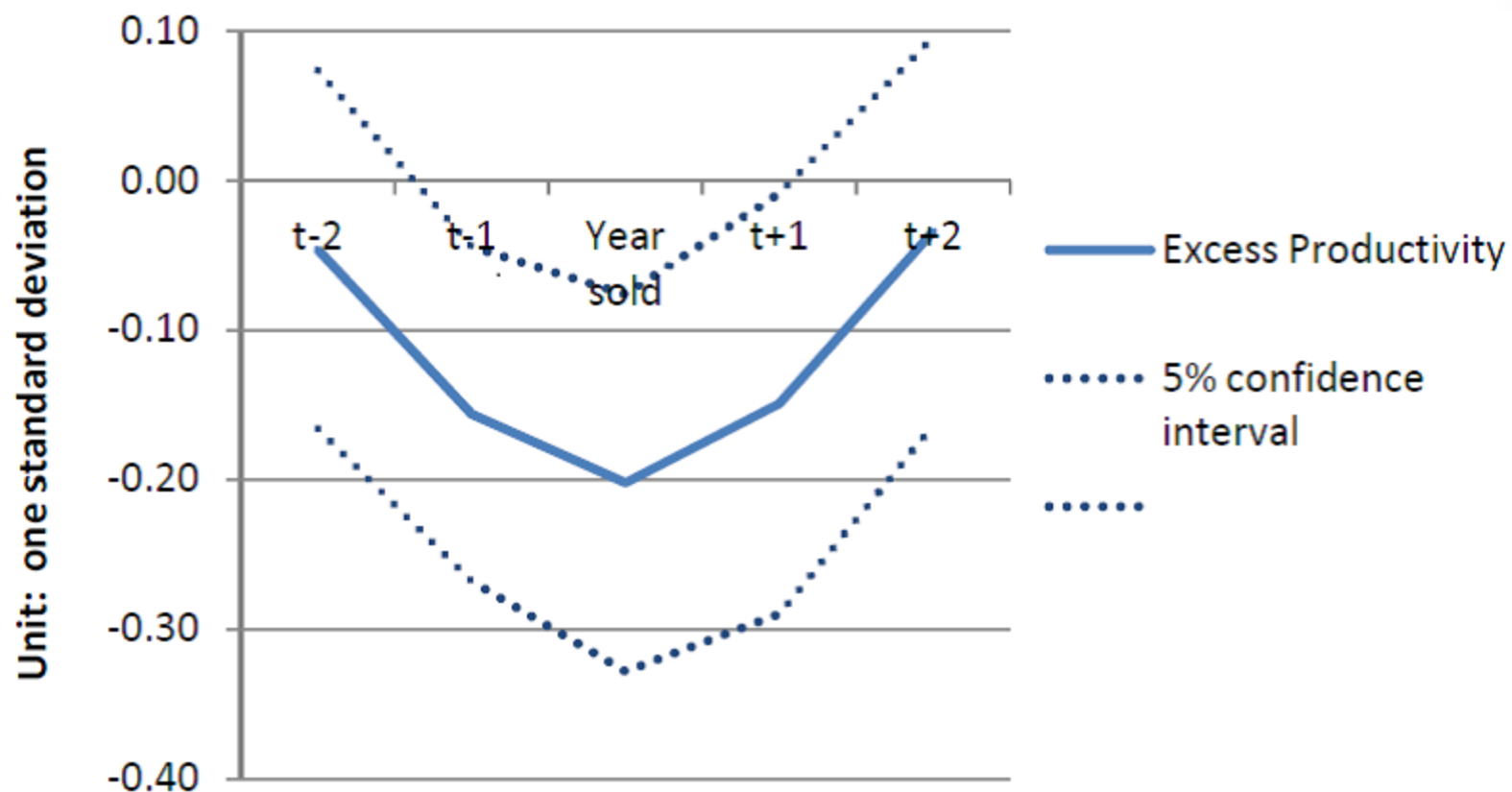


Capital reallocation plays an important role

- Redeployment of capital is a common stated goal of activist hedge funds.
 - Push for the sale of the entire target company in about 20% of events.
 - In another 15% push for the divestiture of under-performing or non-core assets.
- The "sale of the company" objective category generates the highest announcement return.
- Improvement is more significant from divestiture of underperforming assets.

Loss cutting and better matching

(benchmark: same industry-year non-event observations)



The “long term” stock returns

Panel A: CAPM alphas			
	Holding period		
	[-36,-1]	[+1,+36]	[+1,+60]
Median	-0.19	0.53	0.65
Average	-0.09	0.50	0.37
t-stat	1.33	6.06	5.23
Observations	1563	1386	1397
Panel B: Four-factor alphas			
	Holding period		
	[-36,-1]	[+1,+36]	[+1,+60]
Median	-0.35	0.29	0.40
Average	-0.21	0.32	0.16
t-stat	2.92	3.52	2.07
Observations	1563	1386	1397

The units are in months.

Pump and dump?

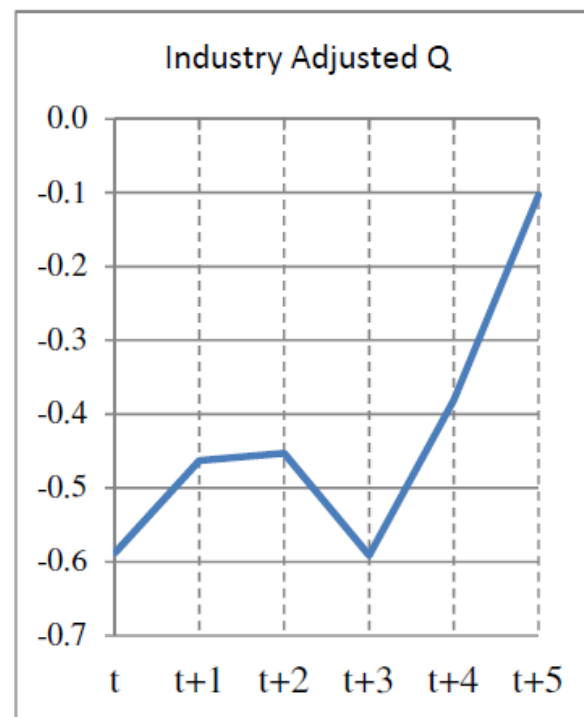
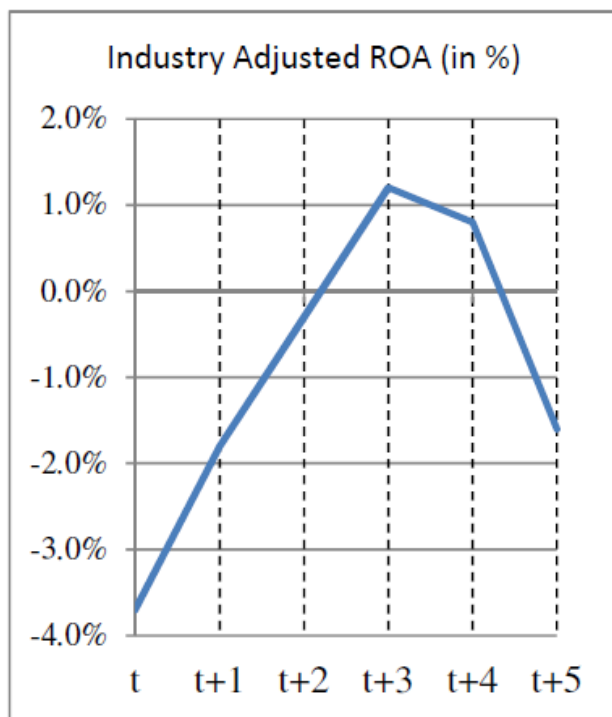
- Month 0: Hedge fund exist.

Panel A: CAPM alphas	
Holding period	[+1,+36]
Median	0.75
Average	0.78
Stdev	3.35
t-stat	6.34
Observations	735

Panel B: Four-factor alphas	
Holding period	[+1,+36]
Median	0.63
Average	0.57
Stdev	3.41
t-stat	4.52
Observations	735

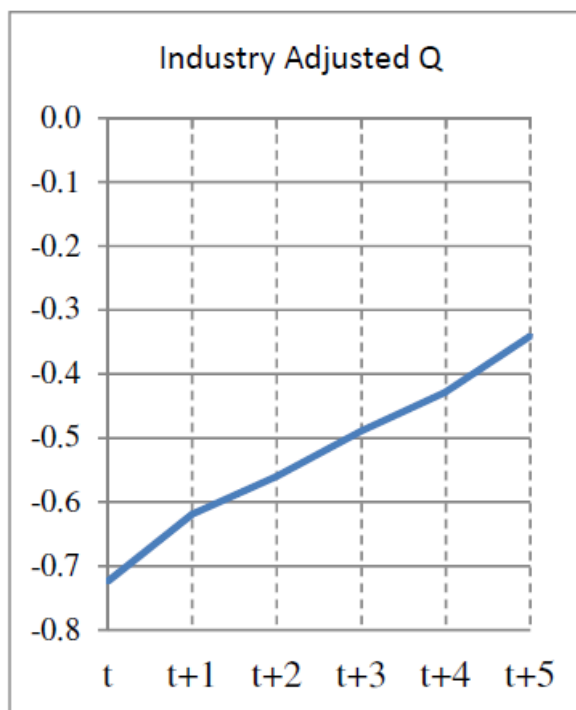
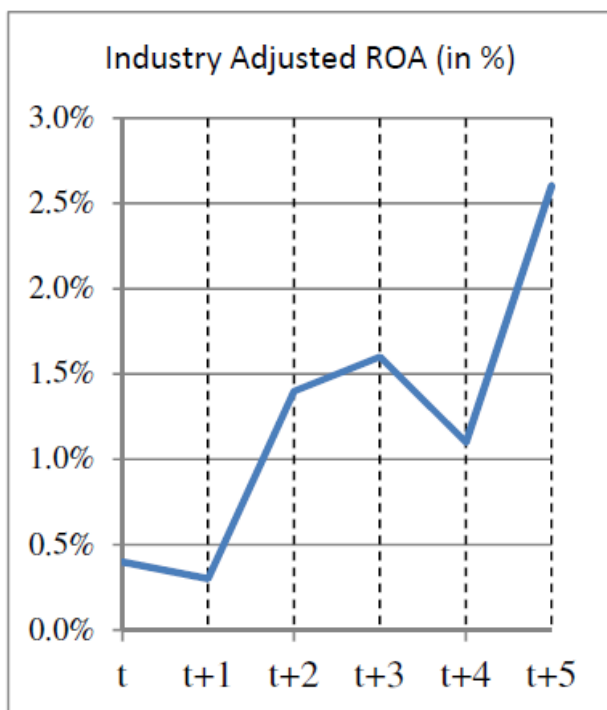
Deals that most like “short-termism”

- “Sacrificing the future for a quick buck:” Leverage enhancing, payout increasing, and investment reducing. About 20% of the sample.



“Adversarial” interventions

- Deals with open confrontation. About 20% of the sample.



Leaner and weaker?

- Operation performance during the Crisis (2008-2009).

Dependent Variable	(1) ΔROA	(2) ΔROA	(3) ΔQ	(4) ΔQ
Targeted during 2004-2007	0.021*** (2.959)	0.018** (2.312)	0.110 (1.404)	0.186** (2.177)
Ln(Market Cap 2006-2007)	0.004** (2.202)	0.006*** (2.882)	-0.071*** (-5.683)	-0.079*** (-5.508)
Ln(Firm age 2006-2007)	-0.000 (-0.168)	0.000 (0.014)	0.155*** (6.300)	0.154*** (5.671)
Industry benchmark?	N	Y	N	Y
R-squared	4,473	4,473	4,626	4,626
Observations	0.003	0.041	0.016	0.096

No significantly difference in the probability of distress-related delisting.

Back to general issues

- Is the association between activist intervention and subsequent improvements “causal?”
 - Activism and stock picking are not mutually exclusive.
 - Concentrated stakes with costly engagements. Cannot be justified for pure stock picking.
 - Non-primary industry segments of target.
 - Improvements after switch from passive to activist filing.
 - “Stock pickers” do not warrant criticism and opposition.
- Is there an easy way to get a “quick buck,” in the public, by destroying firm long-term prospects?
 - To pull off such a trick you would have to do something that the market does not understand properly.

Conclusion: Hedge funds v. management

- The average outcome from intervention so far is positive.
- Hedge fund managers inevitably has less information and expertise than incumbent managers about the firm and the business, but are also less subject to conflicts of interest and biases.
- Open confrontation and hostility is not the modal form of hedge fund activism.
- Timely and frequent evaluation of positions and strategies by both investors and management is not “short-termism.”
- Companies can achieve better outcomes if they avoid a mindset that activists must be resisted.