The Effects of Hedge Fund Activism

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Overview

1. Methodological Contribution.

2. New Evidence on Effects of Activism.

3. Brief Policy Discussion.

Hedge Funds

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- Dozens of published papers exploring everything from profitability to innovation and loan spreads.

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  - The growth in index investing.

  - Change in regulations requiring large institutional investors to vote their shares.

  - Removal of staggered boards.

  - Increase in "wolf pack" strategies.
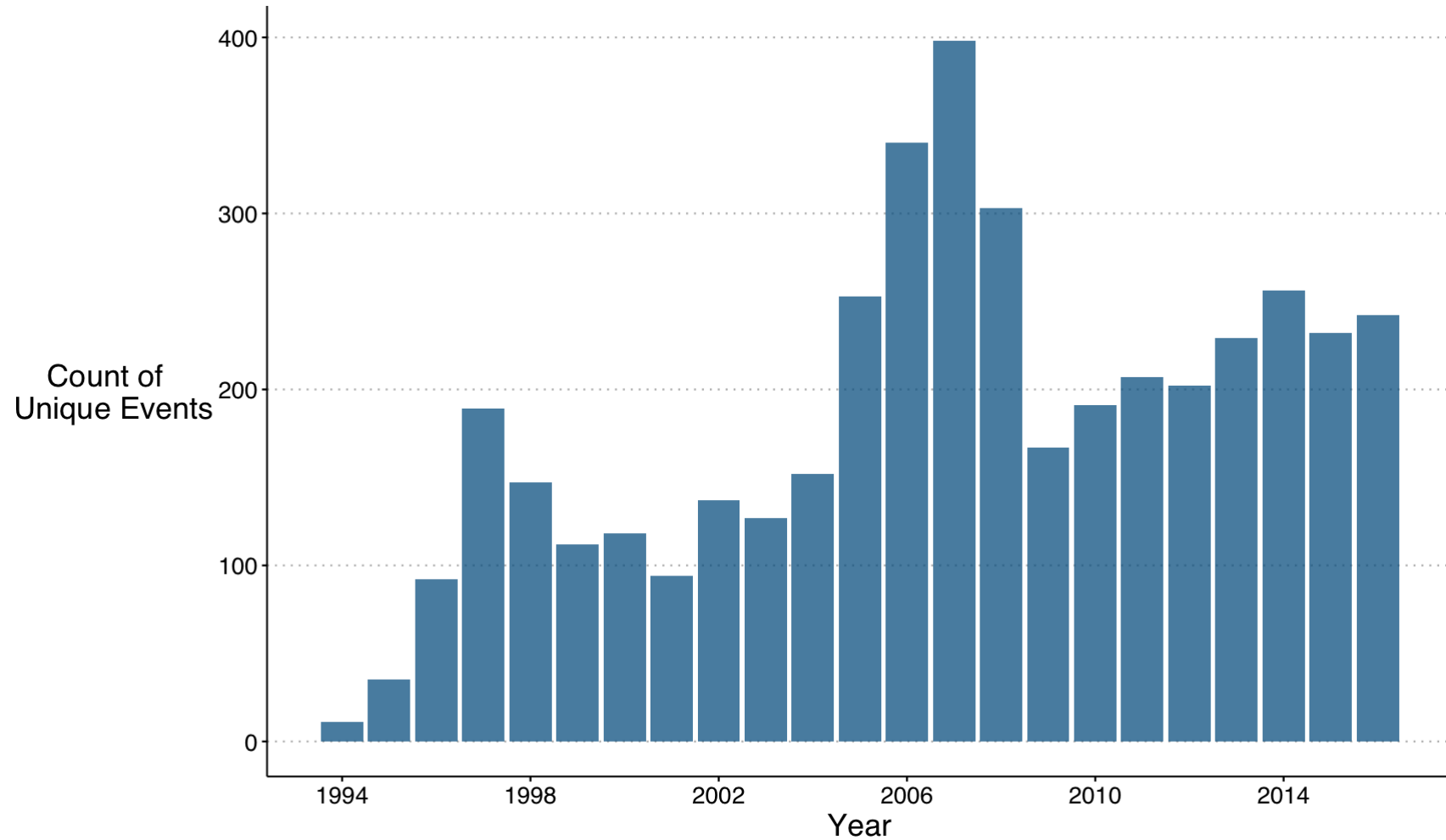
Rise of Activism
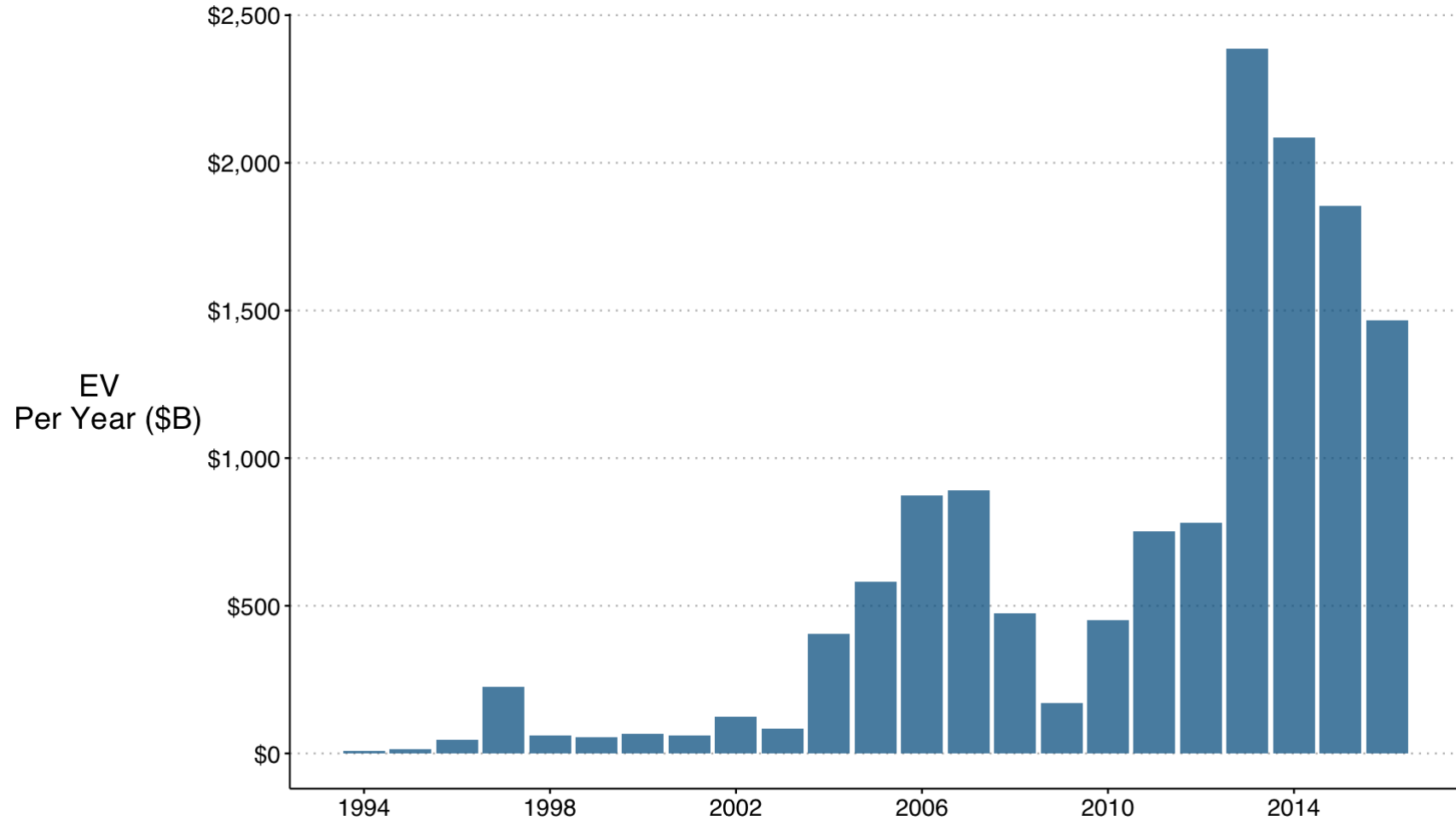
Arguments For and Against Activism

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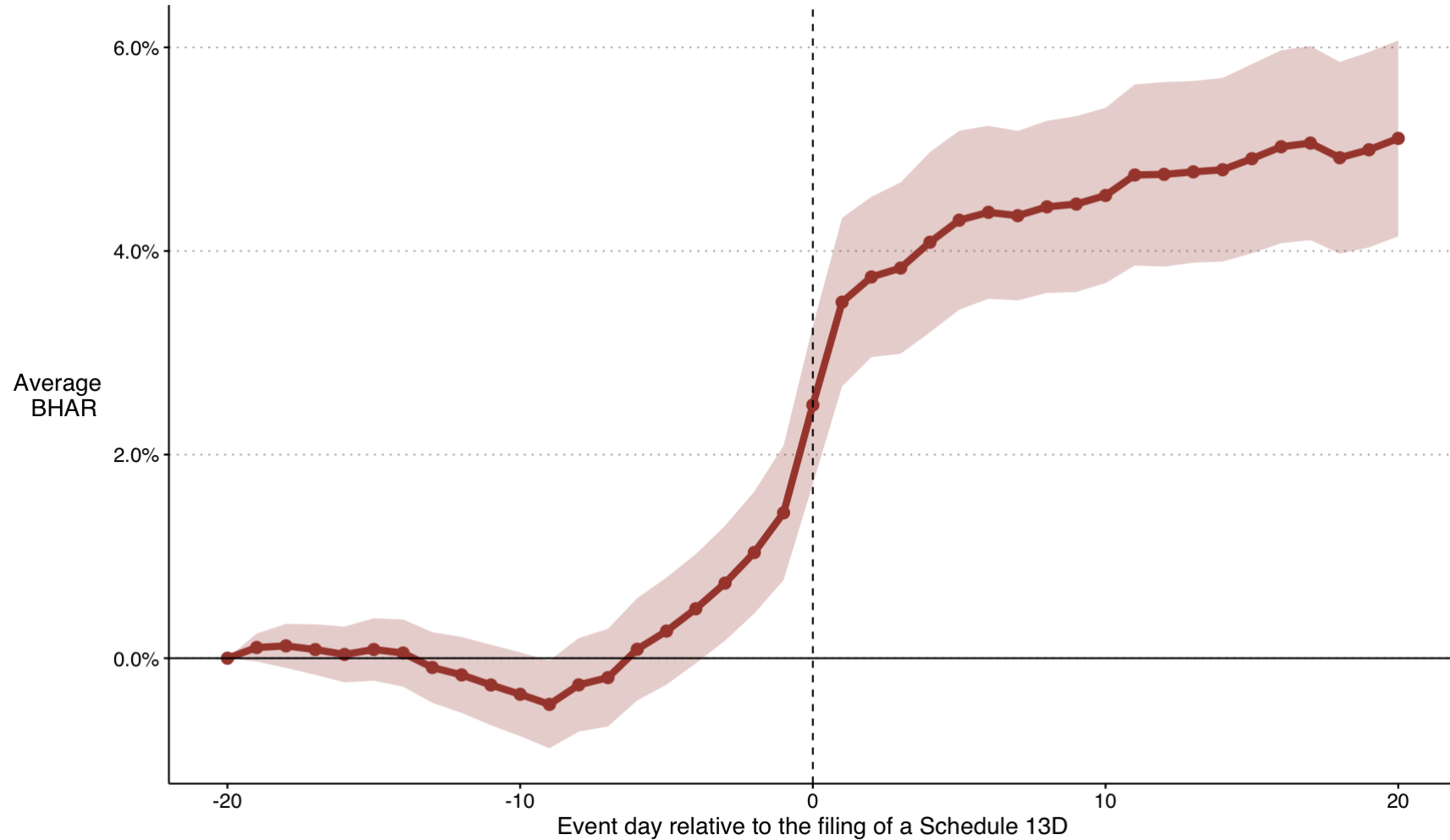- However, the agency problem is not the only problem that firms face.

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    - Kahan and Rock (2007) "archetypal short term investors" that "presents the potentially most important, most controversial, most ambiguous, and most complex problem associated with hedge fund activism.".
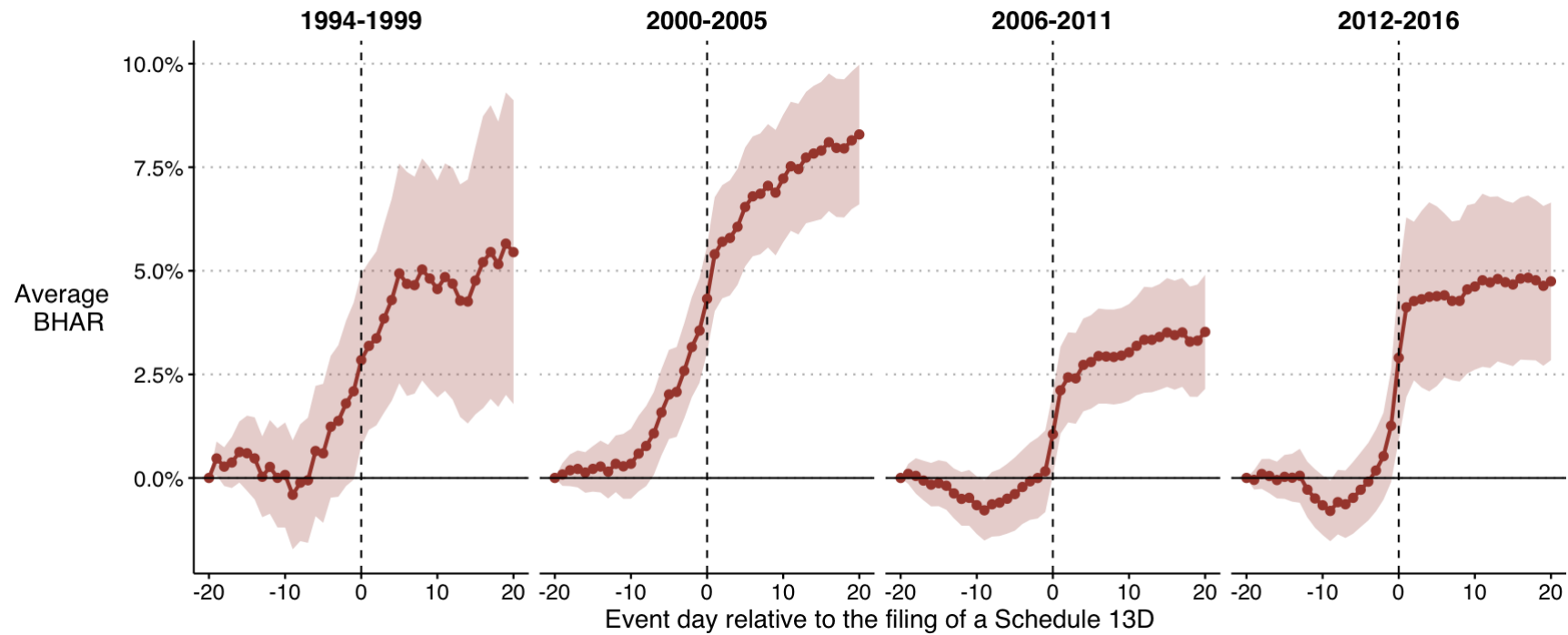
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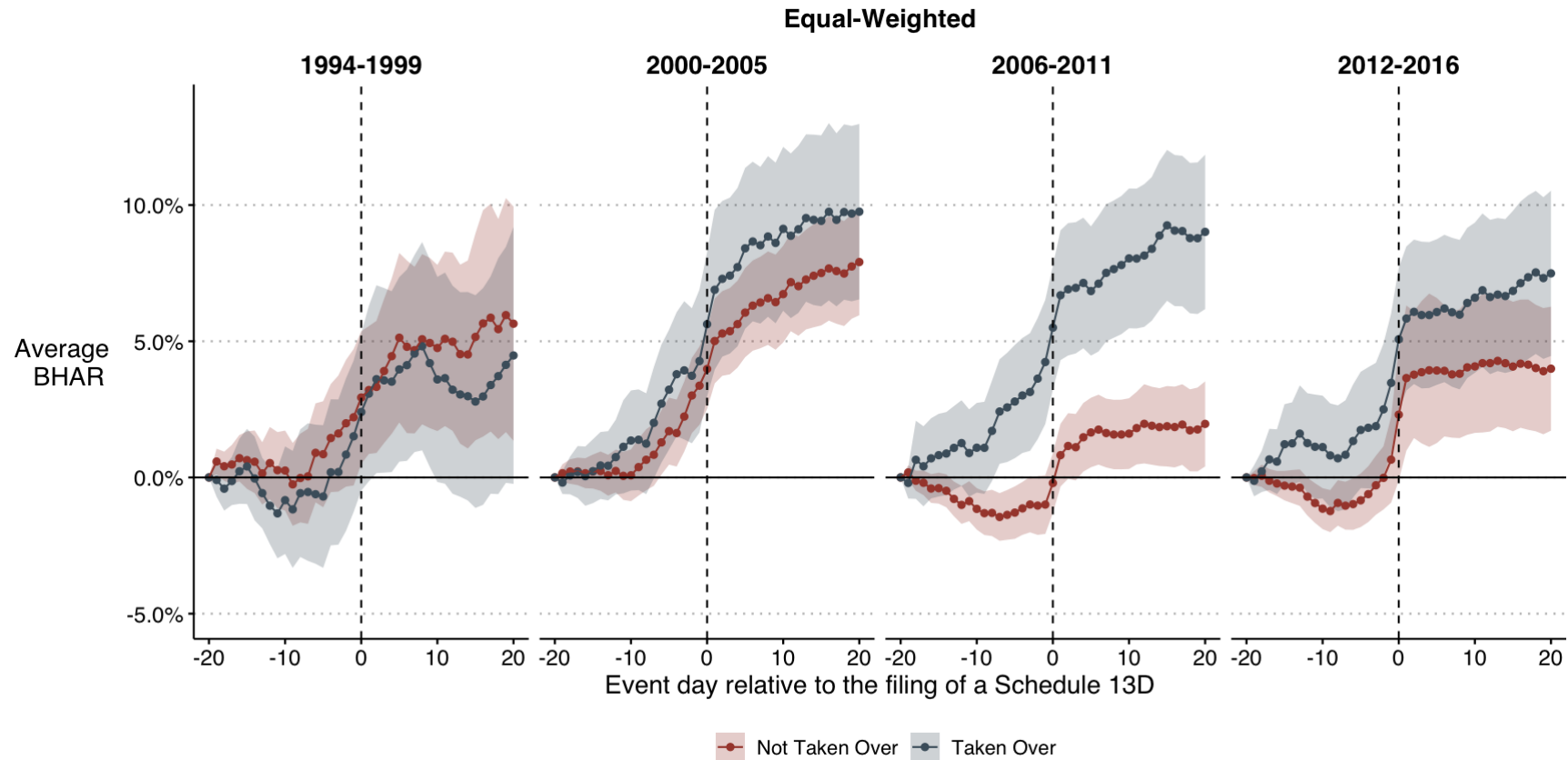   - Activism likely reduces long term investment at firms (Coffee and Palia (2016)).

Short-Run Returns Around Activism

Average BHAR

Event day relative to the filing of a Schedule 13D

... Have Decreased Over Time

Average BHAR vs. Event day relative to the filing of a Schedule 13D, shown across four time periods: 1994-1999, 2000-2005, 2006-2011, and 2012-2016.

... Especially For Non-Takeover Targets

Equal-Weighted

| 1994-1999 | 2000-2005 | 2006-2011 | 2012-2016 |

Average BHAR

Event day relative to the filing of a Schedule 13D

● Not Taken Over   ● Taken Over

Lipton Memo

For companies that are the subject of hedge fund activism and remain independent, what is the impact on their operational performance and stock price performance relative to the benchmark, not just in the short period after announcement of the activist interest, but after a 24-month period.
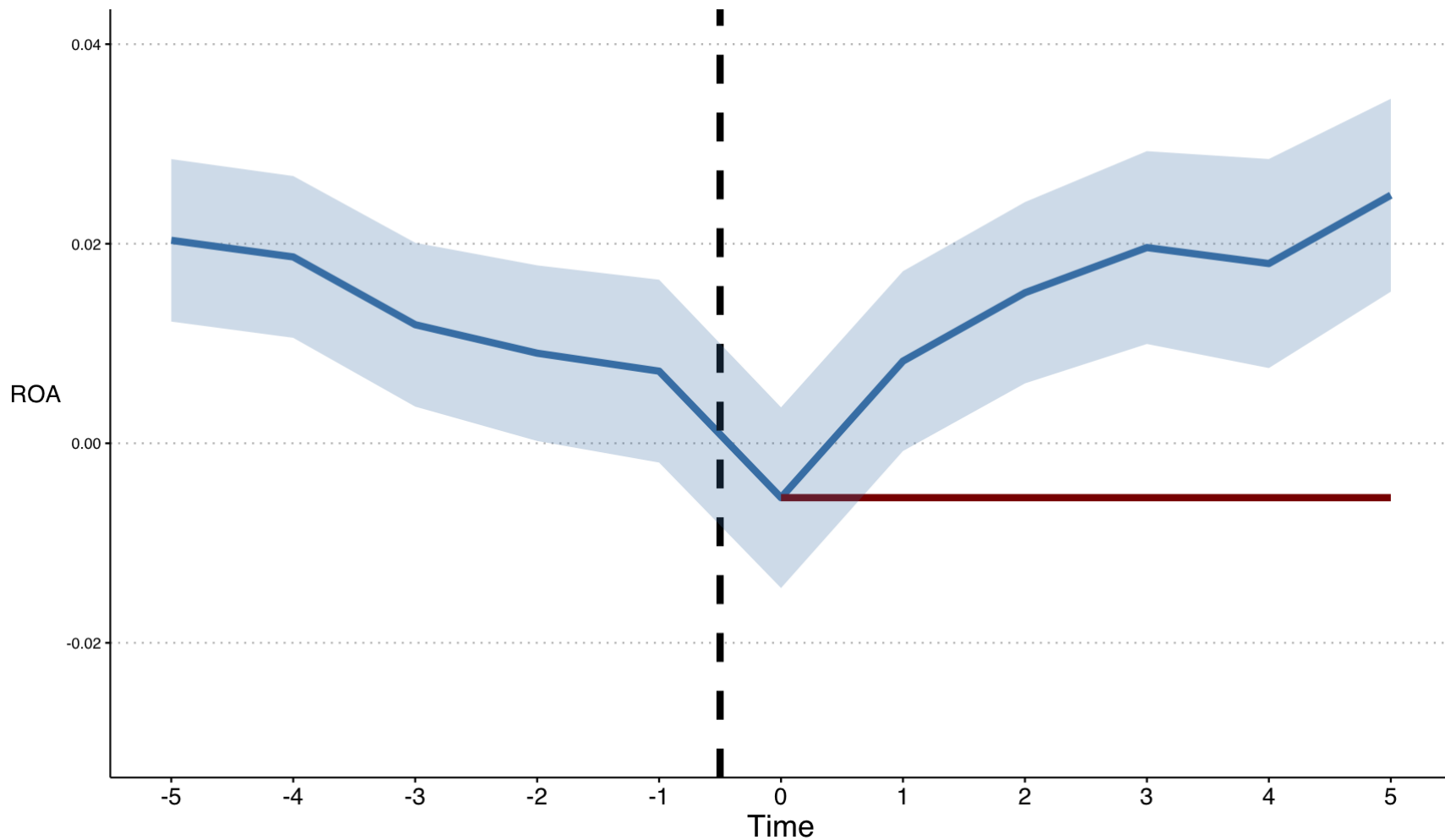
Brav, Bebchuk, and Jiang (2015)

$$roa_{it} = \alpha_j + \lambda_t + \sum_{k=-3}^{5} \gamma_k D_{it} + \beta X_{it} + \epsilon_{it}$$
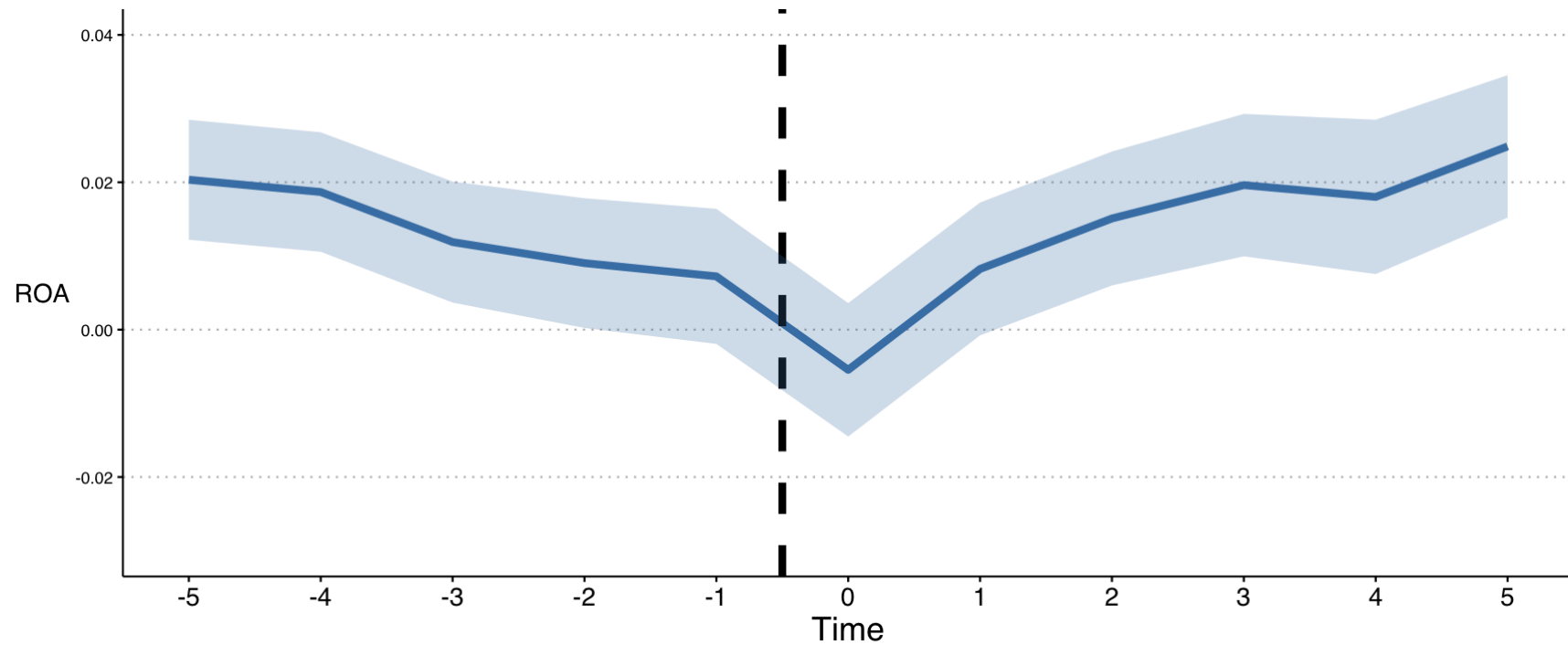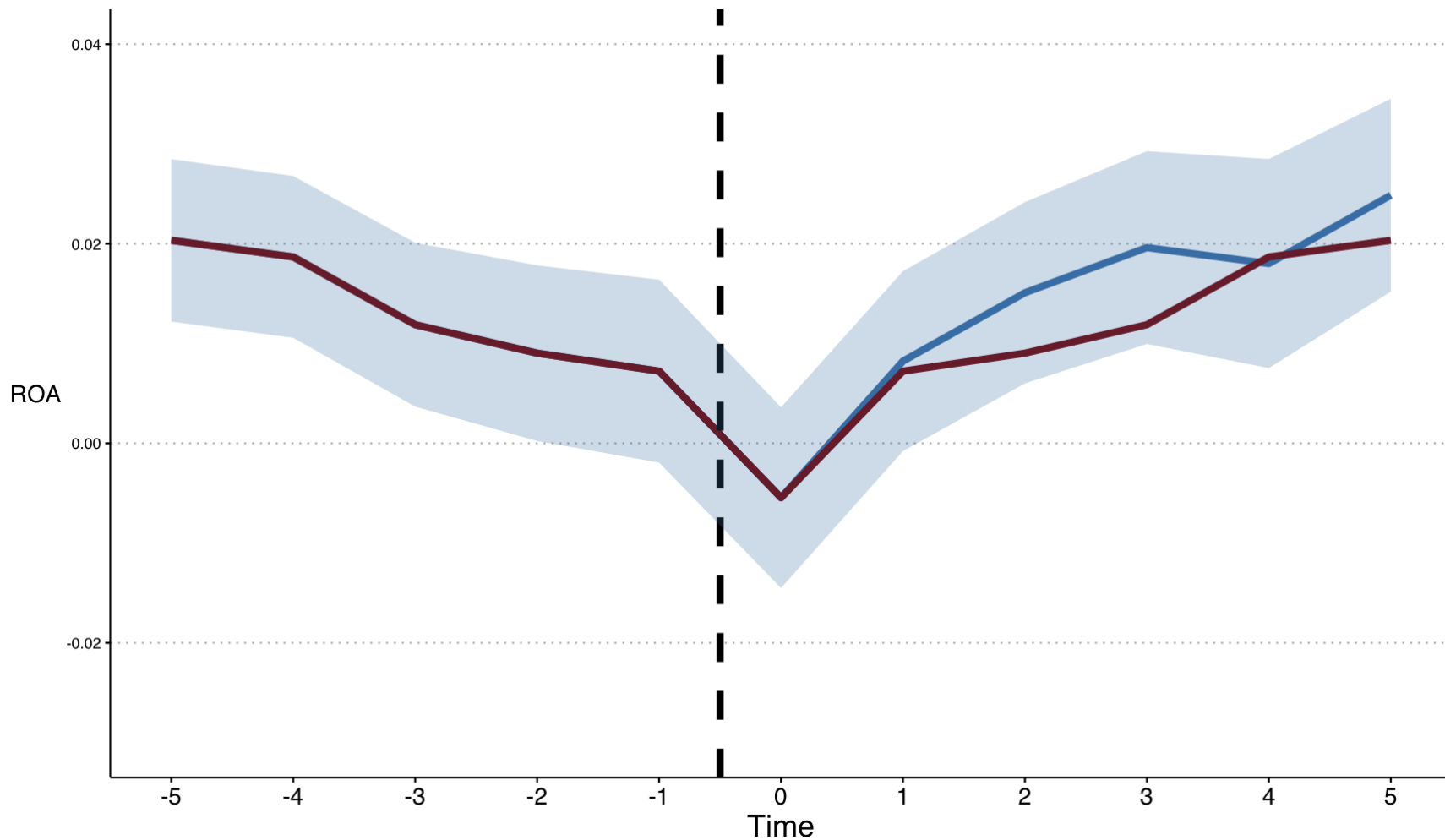
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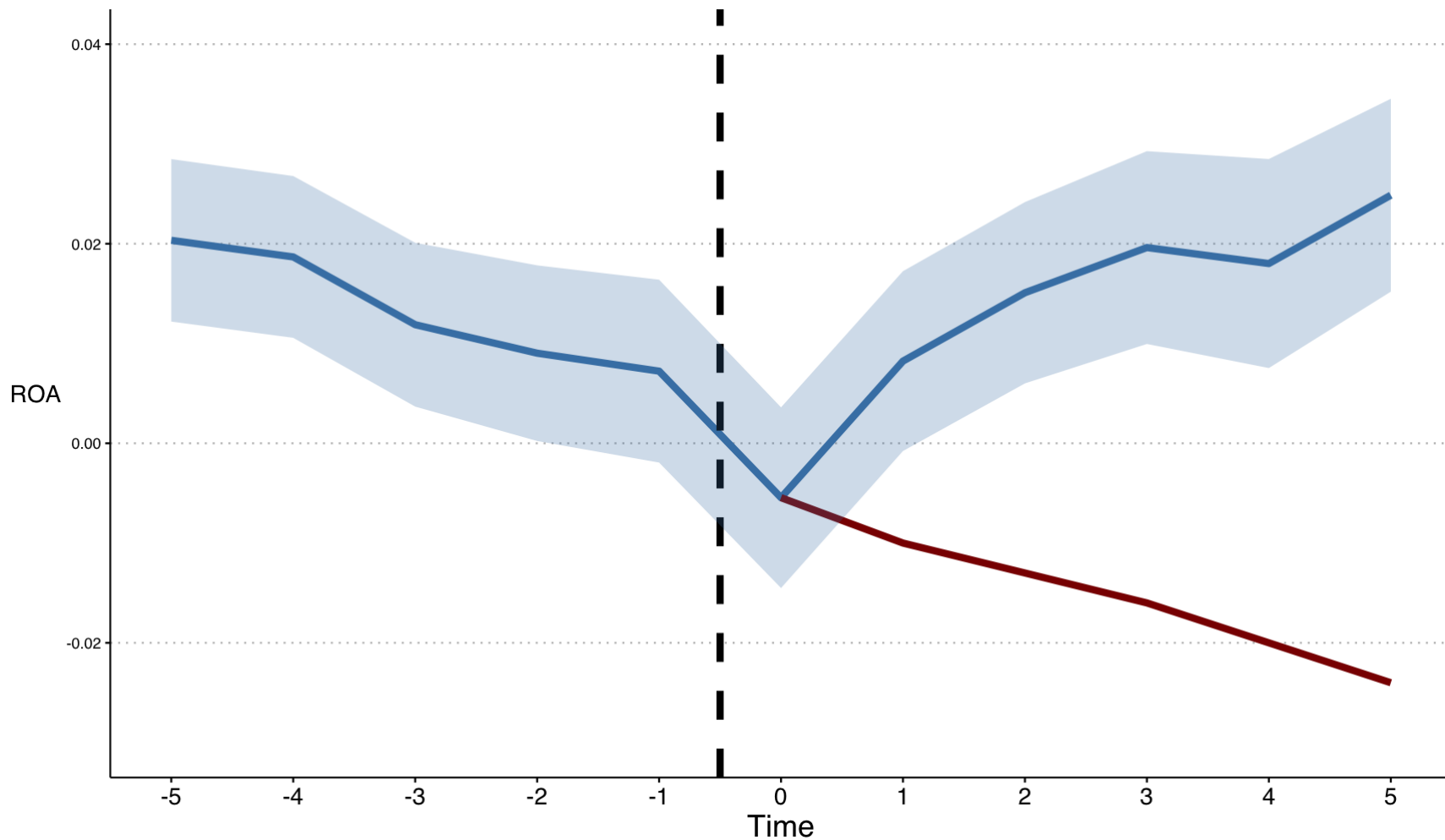
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  - Compare the conditional outcomes of the activist targets to the weighted average of non-targeted firms.

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- Does two things: weights control units by their propensity scores $\left(p_g(X)\right)$, and controls for expected change in the outcome variable based on variables measured pre-treatment $\left(m_{g,t,\delta}^{nev}(X)\right)$.
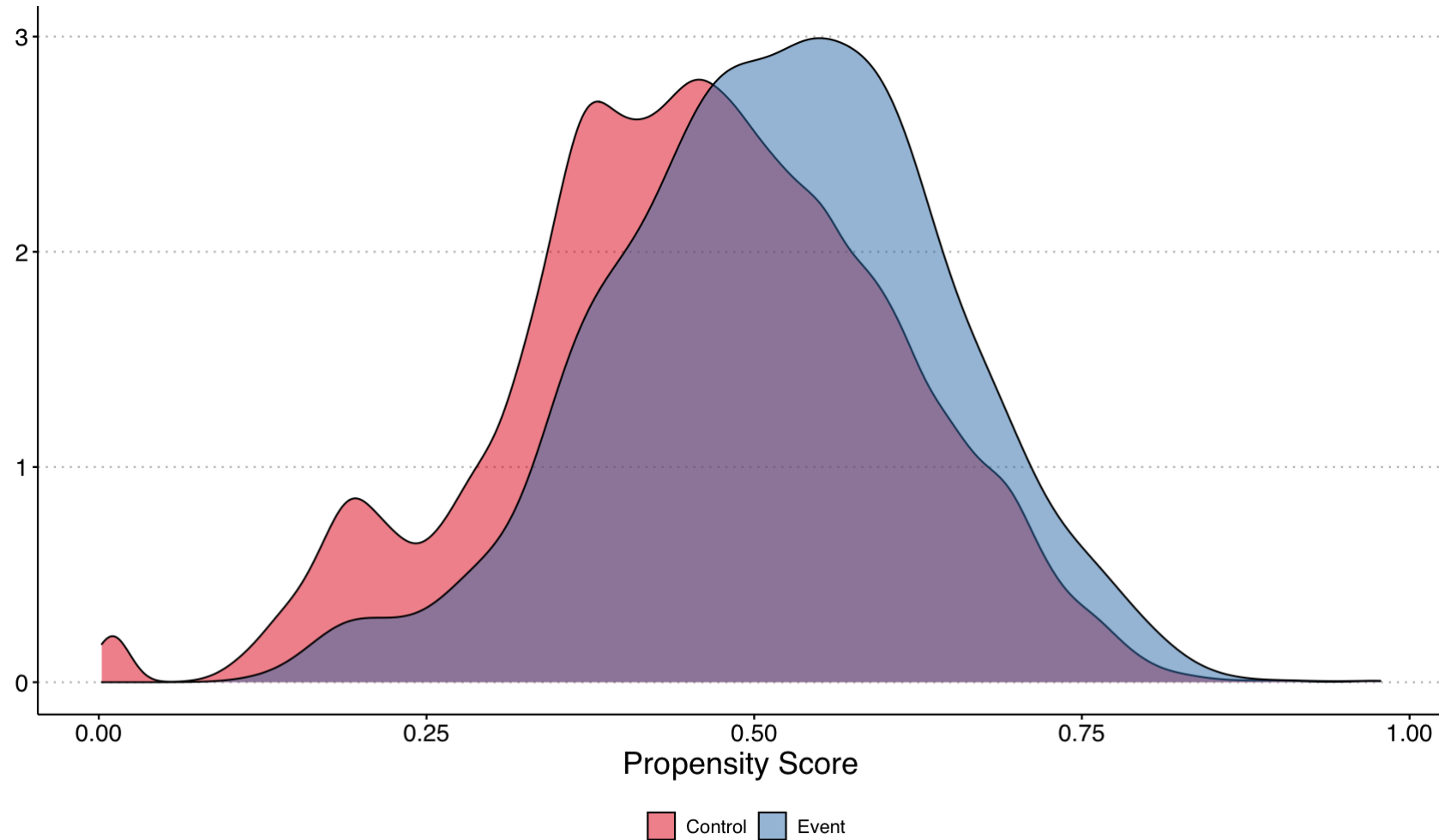
My Propensity Score Distributions

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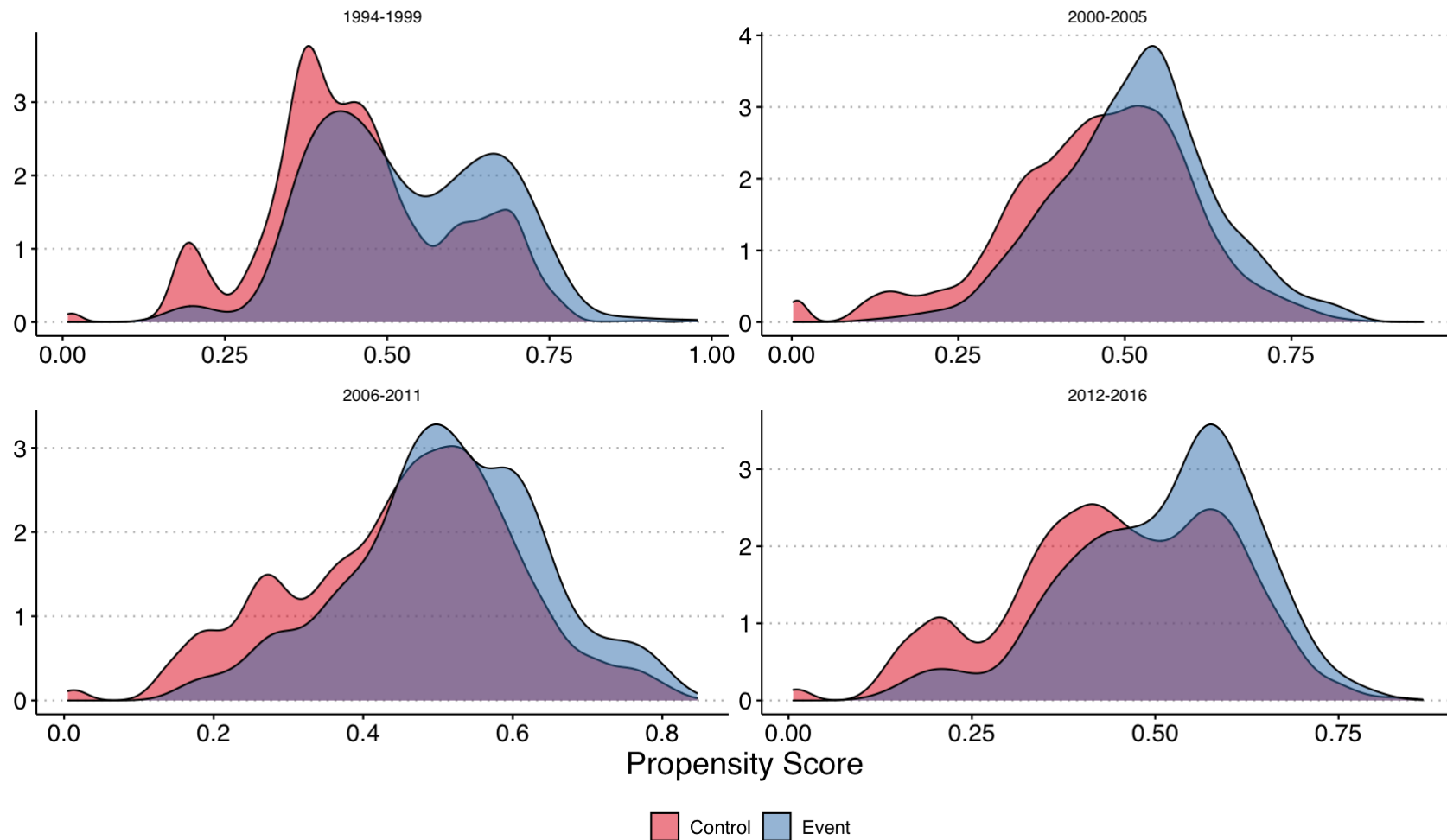1994-1999

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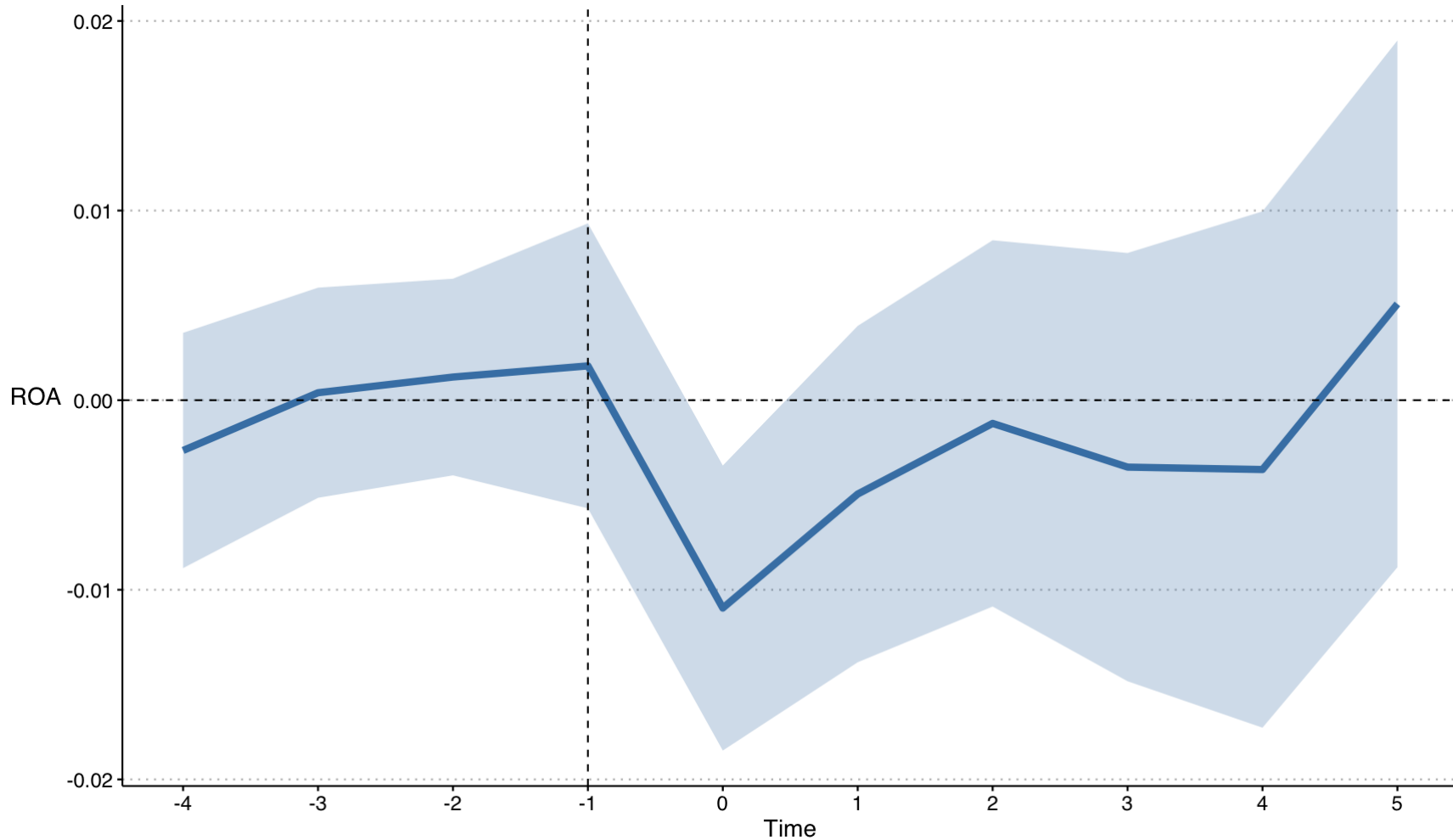
2012-2016

Propensity Score

Control   Event
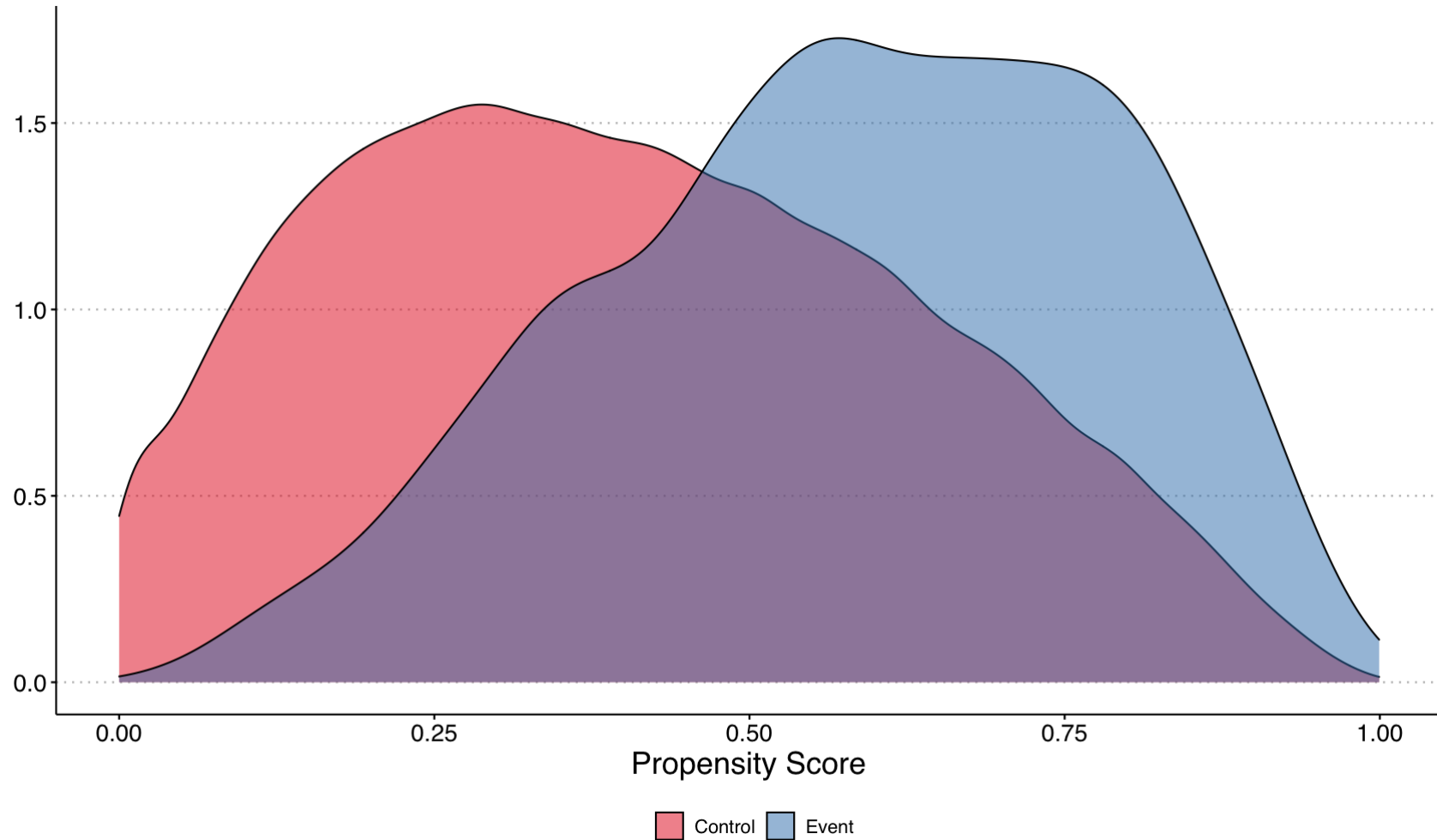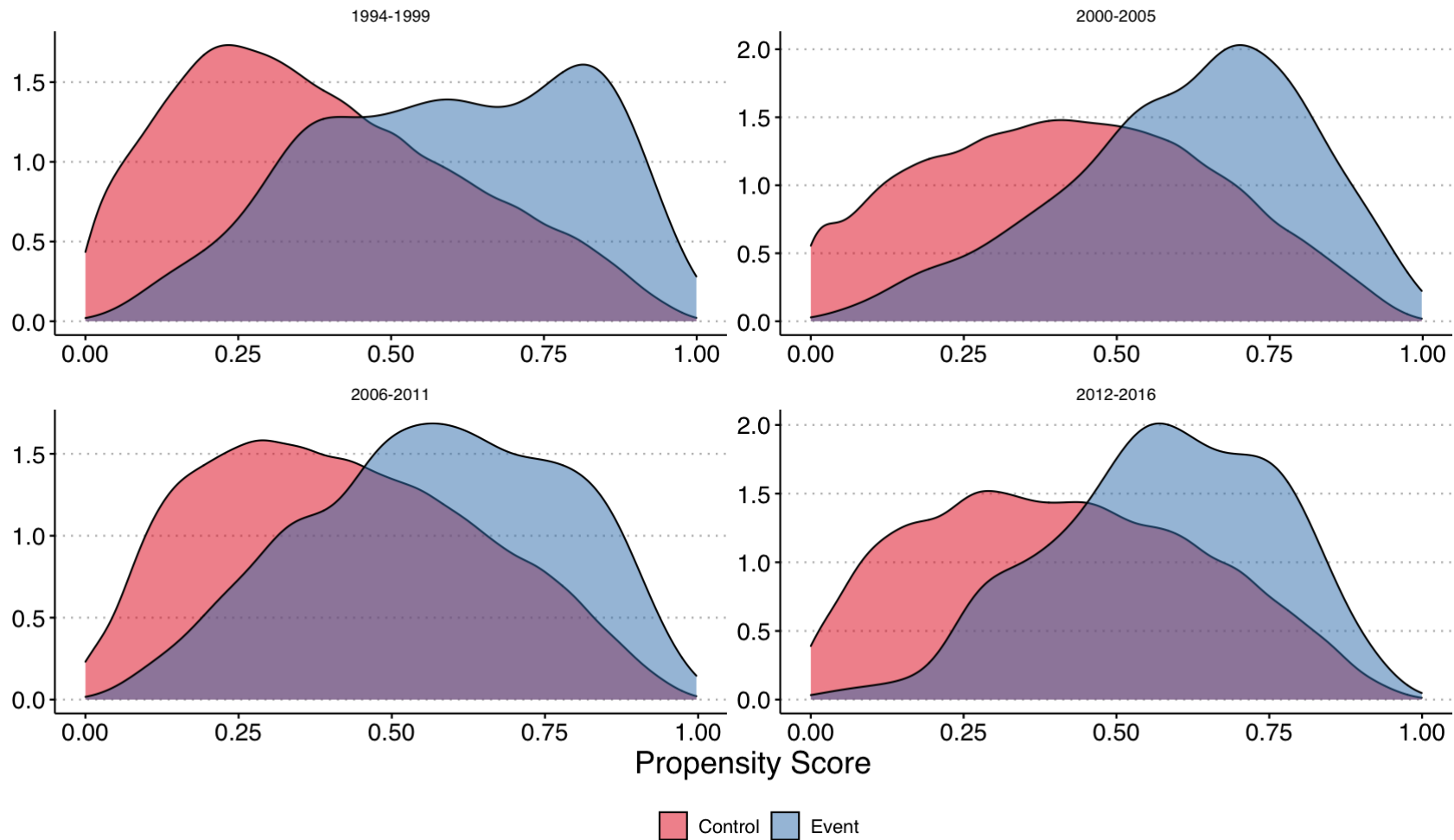
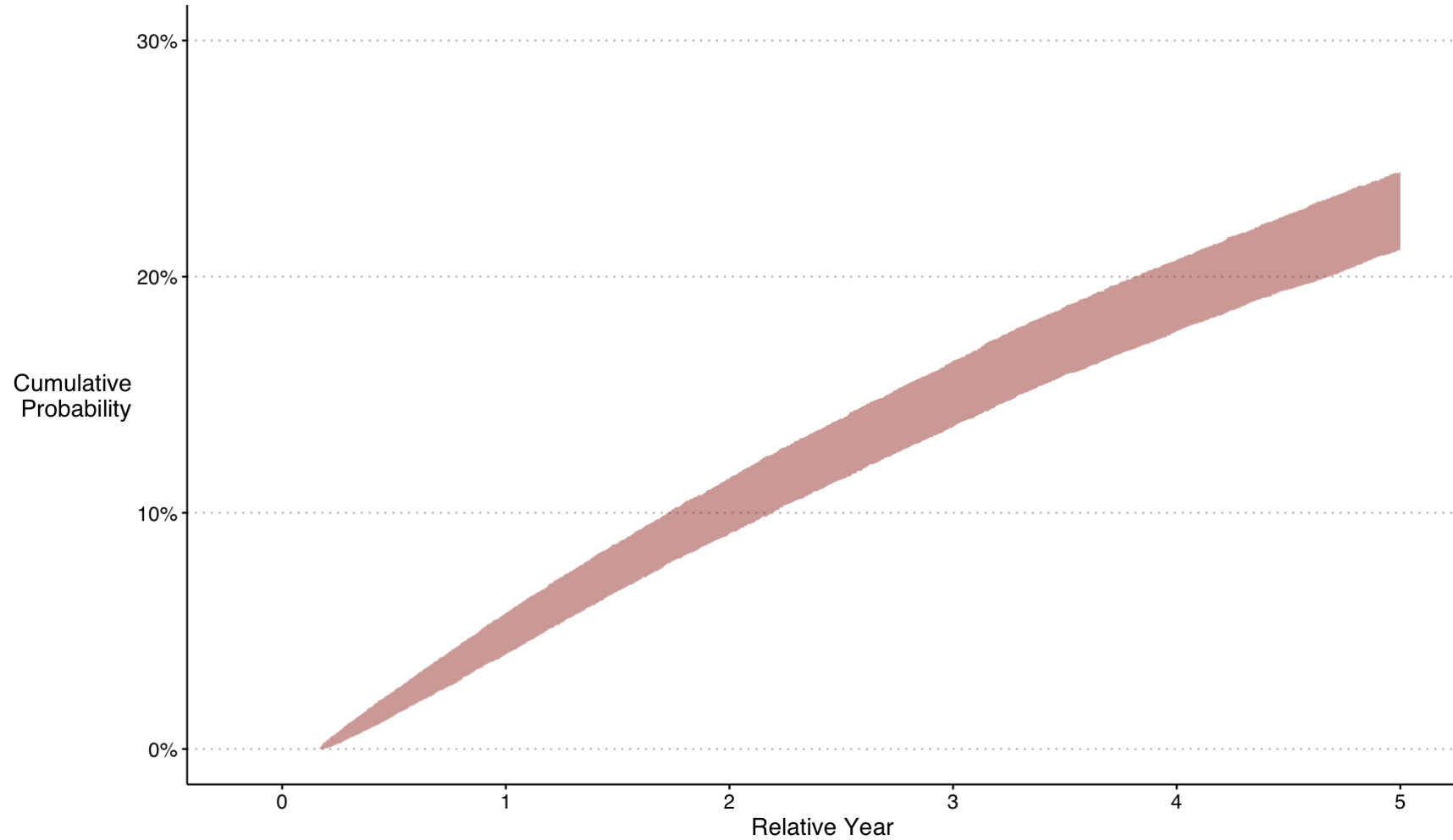Low Dimensional Propensity Score Distributions

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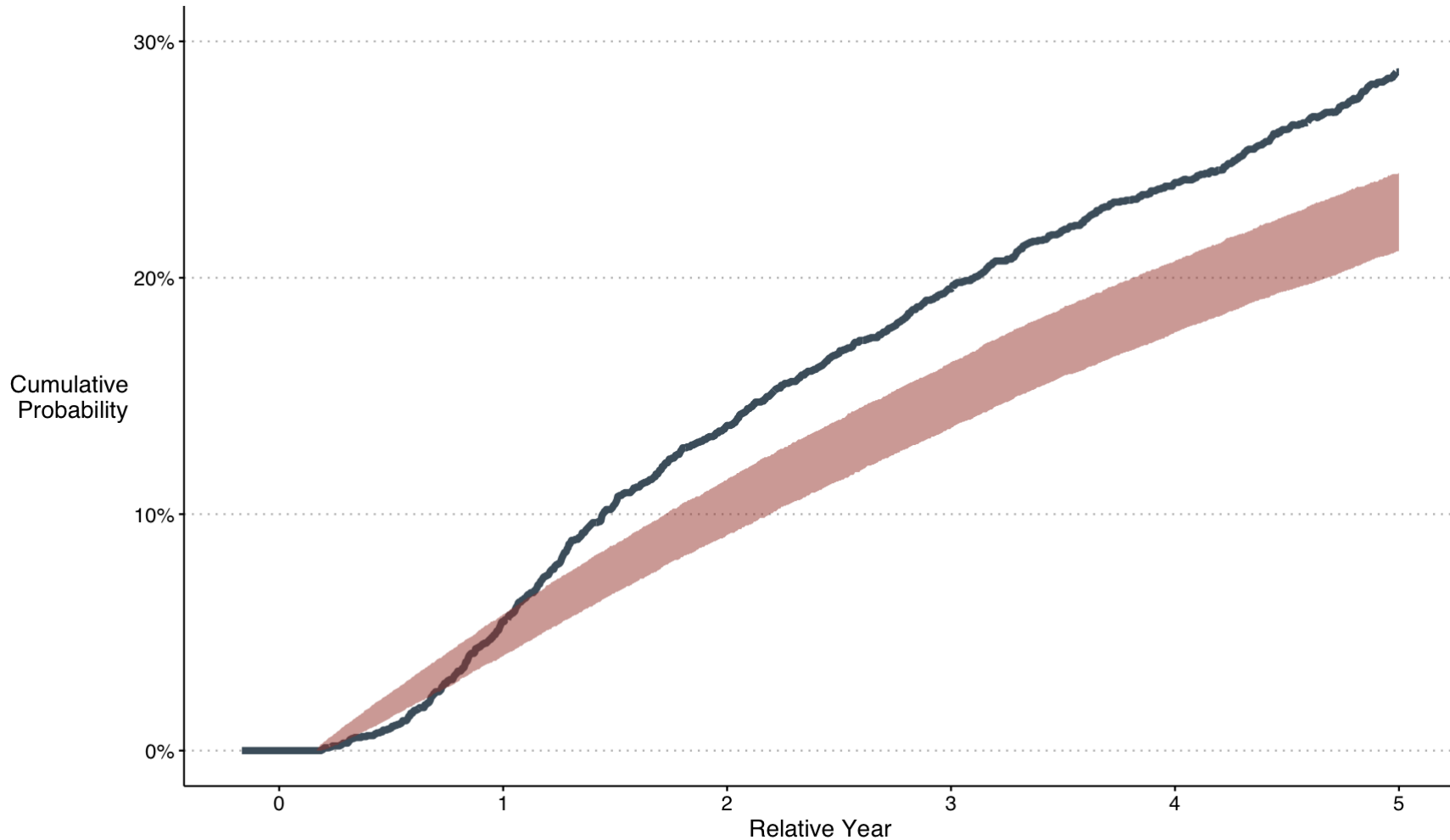# Operating Performance - Return on Assets

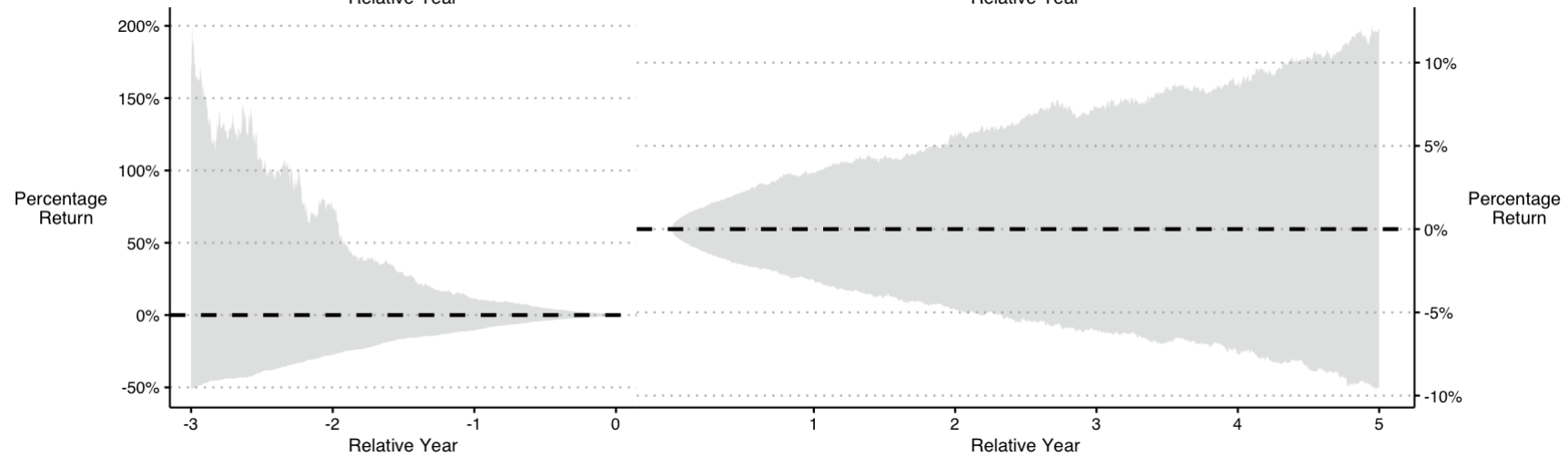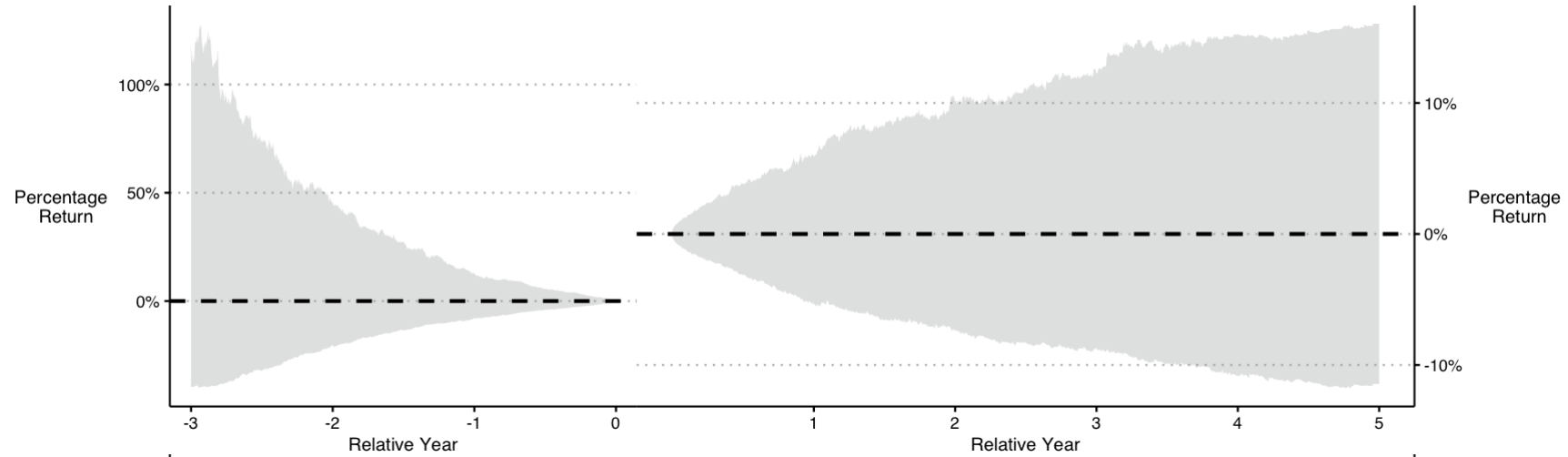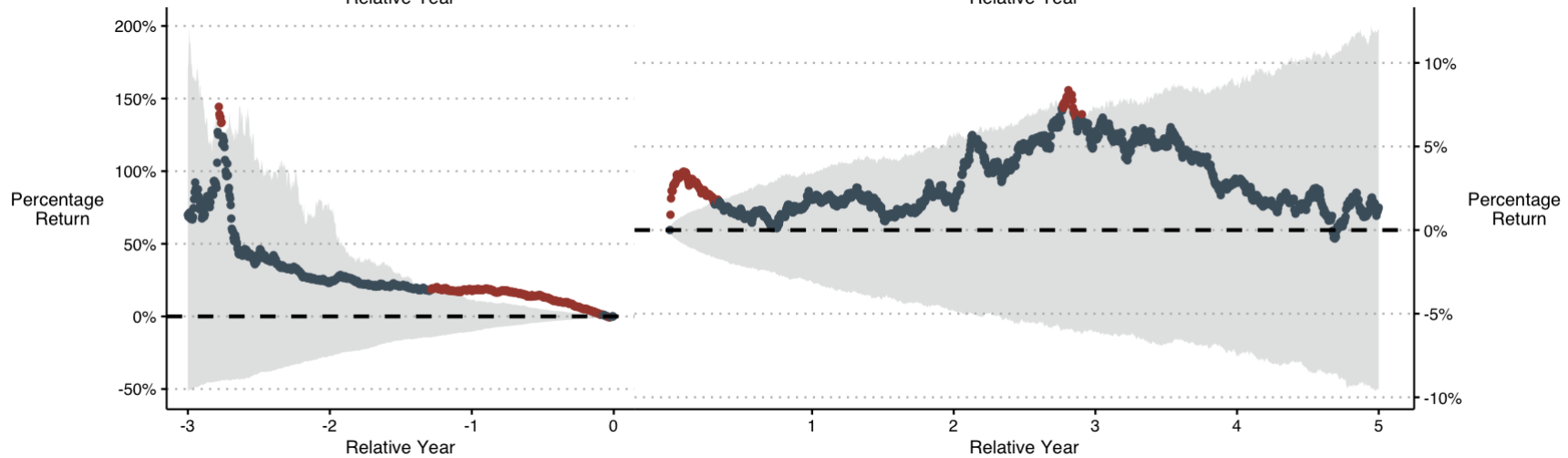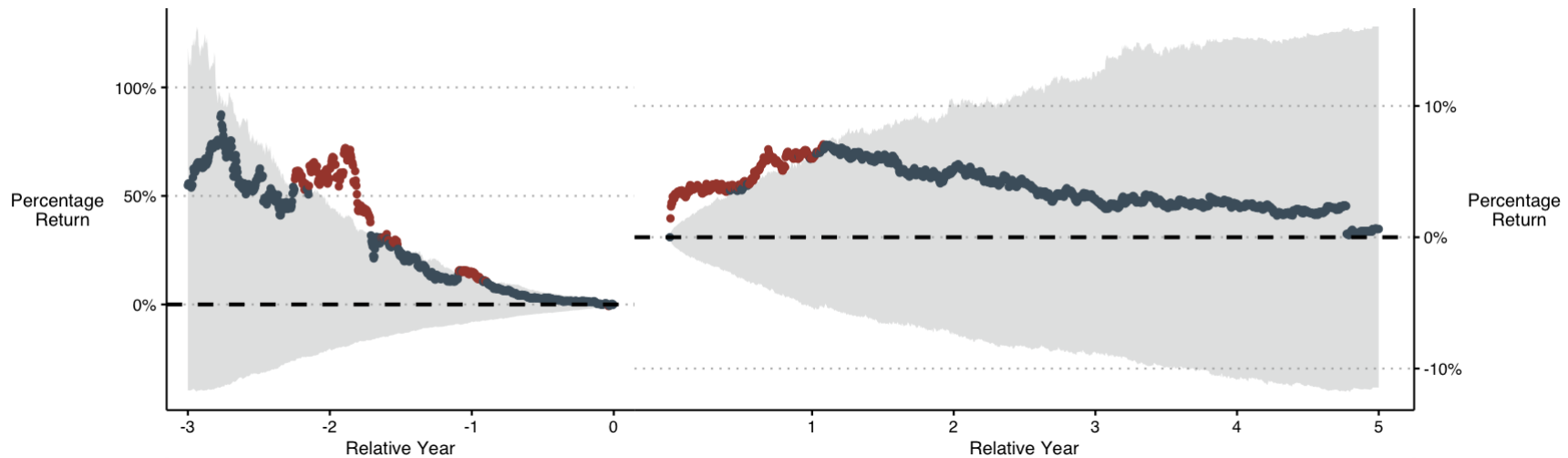# Cumulative Takeover Probability

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Long Run Returns

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- Little evidence to support general argument that activism increases (or decreases) shareholder interests.

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- "Given ... stagnation in median income and wage growth, post-activist intervention gains that **result from reducing labor rents** might well be considered yet another deepening of income inequality that **reduces the wealth of the many to benefit the few**. Human investors care not just about whether corporations make money, but also about how" Strine (2017).

Payouts, Investment, and Debt
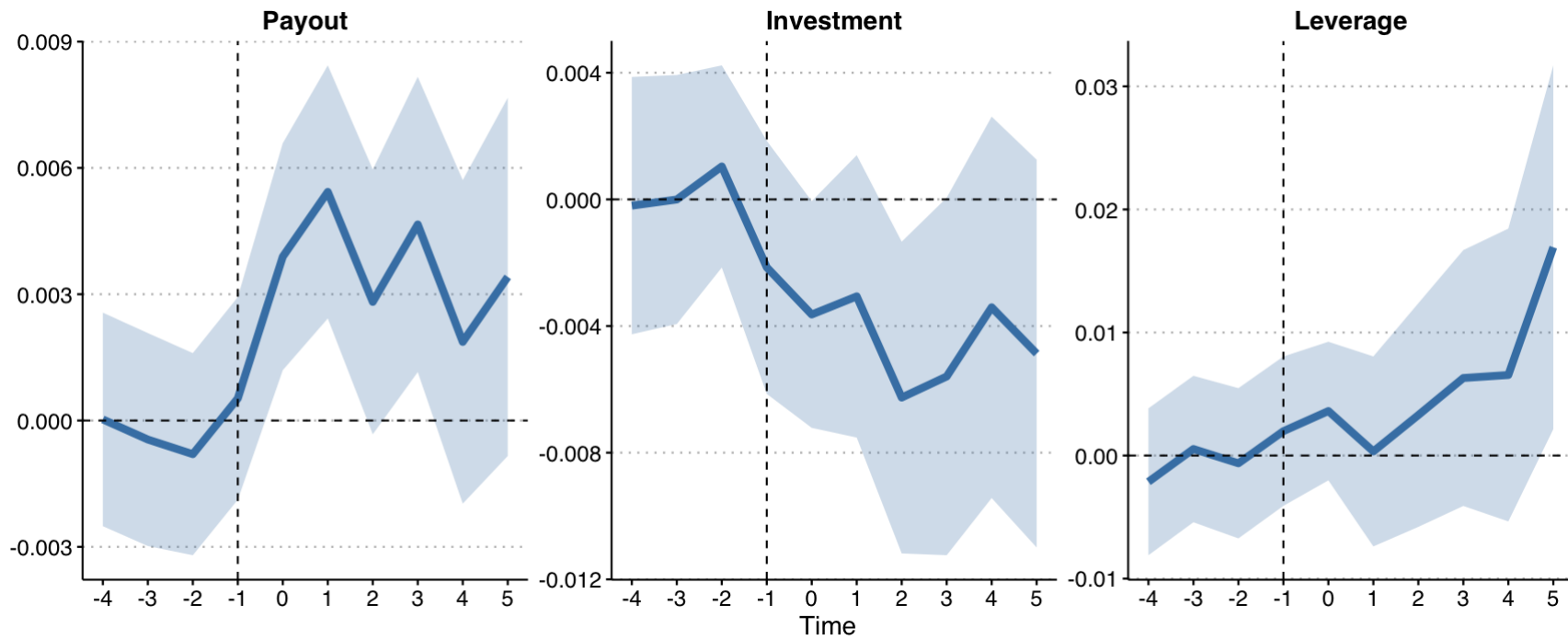
Employment Levels
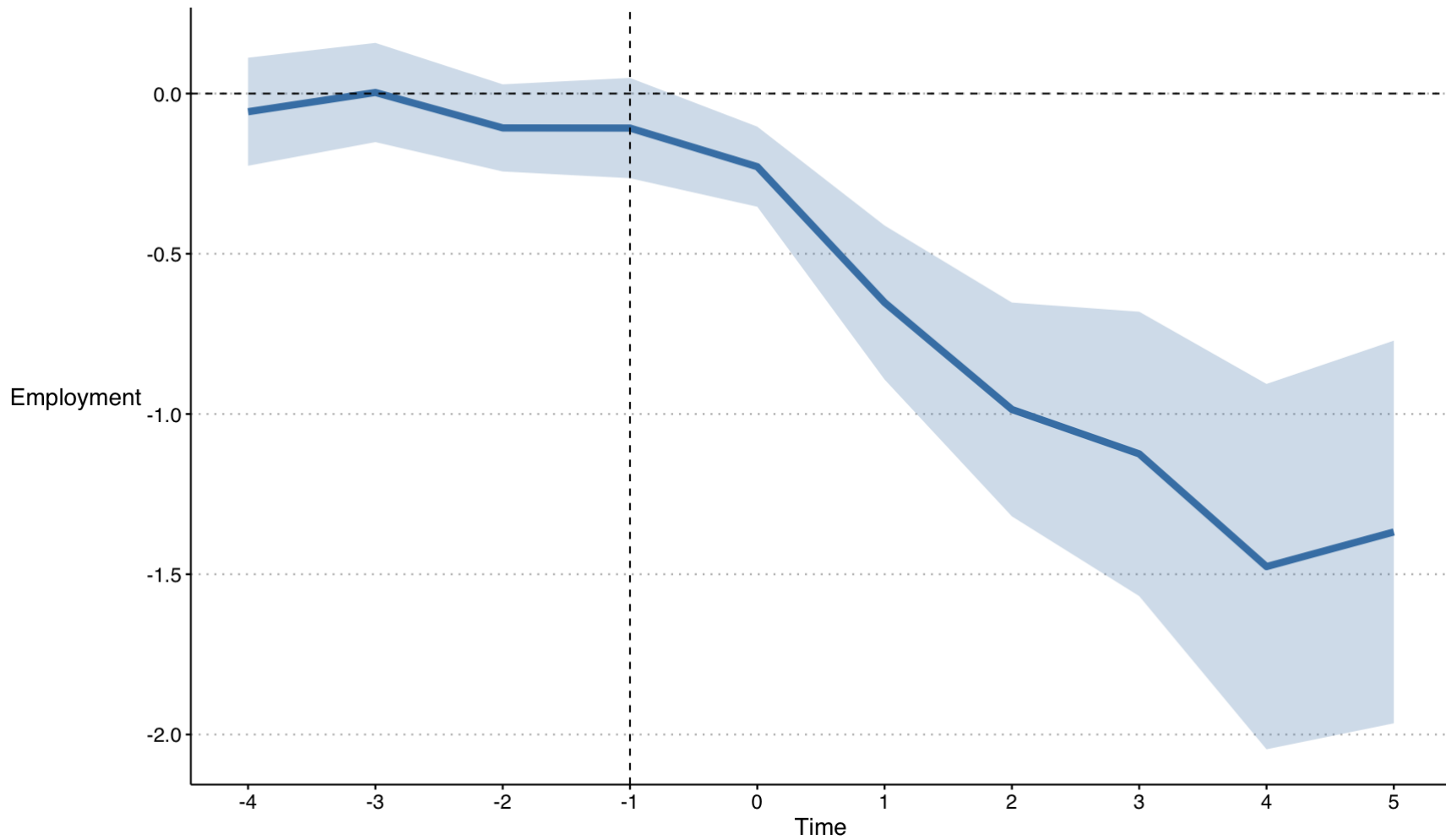
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- In my opinion this risks turning a substantive problem into of inapt process.

Institutional Investors

We have long believed that our clients, as shareholders in your company, will benefit if you can create enduring, sustainable value for all of your stakeholders.

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- **But** it does appear to change payout and investment strategies, and is accompanied by substantial layoffs.

- To the extent that institutional investors are serious about changing managerial focus away from solely shareholder wealth maximization, here is a place to start.