Governance by Persuasion: Hedge Fund Activism and Market-based Shareholder Influence

Alon Brav

Fuqua School of Business, Duke University, ECGI and NBER

**Institute for Corporate Governance
Kelley School of Business, Indiana University**

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Overview

- I plan on talking about hedge fund activism, where hedge funds influence corporate decisions as shareholders, without taking control

- The talk draws on a recent review of the literature on hedge fund activism joint with Rongchen Li and Wei Jiang

Background

- Concentrated equity ownership: The rise of institutional investors
  - Associated with the contemporaneous decline in hostile takeovers
  - Increasing institutional ownership of U.S. companies
  - Black (1992): *"Institutional oversight, through a combination of formal voting initiatives and informal persuasion, can serve as one strand in a web of imperfect constraints on managerial discretion."*

    "...the upside from institutional voice is substantial and the downside is limited."

- Evidence on the efficacy of monitoring by institutional shareholders (e.g., public, private and union pension funds, mutual funds)
  - Black (1998): *"Best reading of currently available evidence is that institutional investor activism does not importantly affect firm performance."*
  - Gillan and Starks (2007): *"There is little evidence of improvement in the long-term operating or stock market performance of the targeted companies."*

Background

- Institutions are subject to agency problems and other constraints:
  - Corporate pension funds and financial institutions may be reluctant to engage corporations with which the sponsoring institution does, or will do, business
  - Public pension funds may be managed by officials with personal/political agendas. These goals may not be to maximize shareholder value
  - Public pension funds are primarily defined benefit funds. If a public pension fund does not perform well to cover the fixed obligated payment to its beneficiaries, the shortfall comes from taxpayers
  - The SEC limits the type of (performance) fees that companies regulated by the Investment Company Act of 1940 may charge. The resulting weak personal financial incentives weaken the will to engage in interventions
  - Legal rules limiting institutional ownership
  - Money managers that track an index want to lower costs associated with monitoring so as to increase performance
  - Regulatory constraints: Restrictions on diversification, shorting, use of derivatives, leverage, and investments in illiquid securities
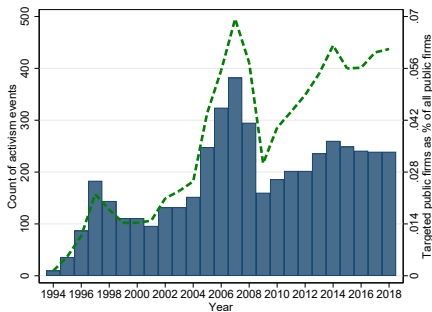
Background

- Hedge funds vs. other institutional investors

  1. Manager's incentives (2% asset management fee and 20% of the profits)

  2. Fewer conflicts of interest

  3. Not subject to heightened fiduciary standards (ERISA) or "prudent man" investing standards

  4. Flexibility in using derivatives, shorting, large stakes in a few companies, use of leverage, less disclosure, use of "lock-ups"

$\Rightarrow$ Activism by hedge funds is strategic and ex ante whereas that by other institutional investors is incidental and ex post
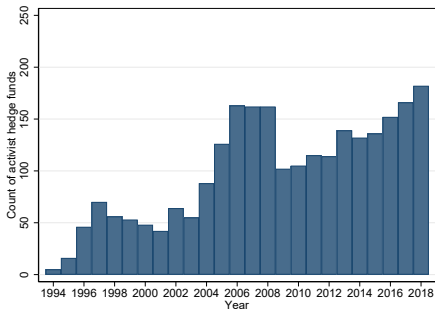
Background

- Evidence on the impact of hedge fund activism to date:
    - Objectives and tactics, capital invested and stake size, rate of success
    - Liquidity and block formation
    - Short and long-term market reaction
    - Long-run profitability, and total factor productivity
    - Firm policies (e.g., payout, governance)
    - Innovation (R&D, patents)
    - Internal capital markets
    - Impact on the market for corporate control
    - Impact on rival firms
    - "wolf packs"
    - Impact of institutional investors on activism
    - Threat of hedge fund activism
    - Reputation and organizational structure
    - Impact on other stakeholders (CEOs, employees, bondholders, environment)
    - Causality

Number of hedge funds and activism events by year, 1994-2018

Activist interventions

Hedge Fund Activists

- Median activist ownership stake stable at 6.6%

Background

- The trend in hedge fund activism coincides with the increase in institutional ownership in the U.S. equity market

% institutional ownership of median S&P 500 firm
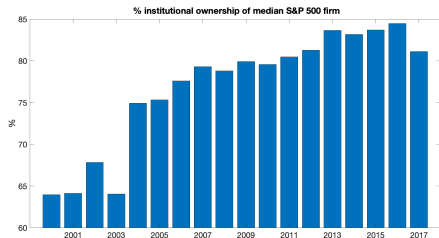
FIGURE 2.8
Index Fund Share of US Stock Market Is Small
Percentage of US stock market capitalization, year-end
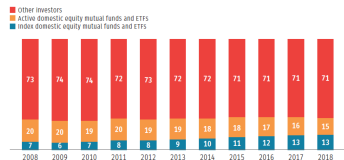
- Index domestic equity mutual funds and ETFs remain a relatively small part of US stock markets, holding only 13 percent of the value of US stocks at year-end 2017. Actively managed domestic equity mutual funds and ETFs held another 15 percent

- Hedge funds, pension funds, life insurance companies, and individuals held the remaining 71 percent

Source: 2019 ICI Investment Company Fact Book. www.icifactbook.org

Background

Rock (2015): "...*institutional investors are now willing to support hedge funds and other corporate governance activists when they are convinced that doing so will increase firm value. As one hedge fund manager explains, "The brute force of ownership is not required anymore because the big institutional players listen to both sides and are willing to back the activist fund if they believe in them* ... **You can win with persuasion and ideas**.*""*

Background
Evidence
Policy Implications / Summary

Impact on the target firm
Impact on other stakeholders
Causality
Current Research

Data

- Section 13(d) of the 1934 Securities Exchange Act requires investors who are beneficial owners of over 5% of any class of publicly traded securities, and who have an intention to influence corporate control, to disclose their ownership and intent within 10 days of crossing the 5% threshold
  - Information on the identity of the filer, filing date, ownership and its changes, cost of purchase, and the purpose of the investment

- Search for events in which the activist did not cross the 5% threshold

- Sample period 1994-2018
  - Filter out banks, brokerage companies, regular corporations, foreign inst', trusts, individuals, insurance companies, pension funds, and other misc' categories
  - Exclude events in which the primary purpose of the filer is either to be involved in (1) the bankruptcy reorganization or the financing of a distressed firm; or (2) to engage in a merger and acquisition related risk arbitrage; or (3) the target is a closed-end fund or other non-regular corporation
  - Gather information on the hedge fund's motive, the target's response, and the development and resolution of the events

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Distribution of activist events per hedge fund, pre- and post-crisis
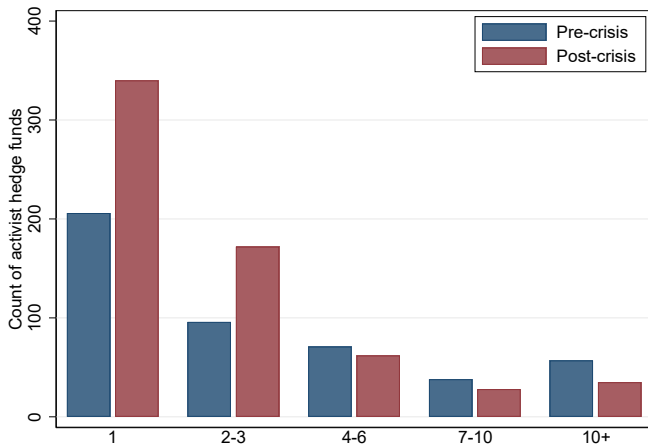
Summary of events by hedge funds' stated goals and tactics

Summary of Hedge Funds' Stated Objectives				
	Full Sample Statistics		Subsample Statistics	
	Number of Events	% of Sample	% Initially Hostile	% Ex-post Hostile
General undervaluation	2191.0	47.0	–	–
Capital structure	609.0	13.1	18.4	19.5
Business strategy	863.0	18.5	20.5	23.1
Sale of target company	861.0	18.5	26.1	26.8
Governance	1654.0	35.5	23.2	25.3

Summary of Hedge Funds' Tactics	
Tactic categories	% of Events
1. The stake is for investment purposes. Alternatively, the intent is to communicate with the board/management to enhance shareholder value.	49.3
2. The hedge fund seeks board representation without a proxy contest or confrontation with the existing management/board.	23.4
3. The hedge fund makes formal shareholder proposals, or publicly criticizes the company and demands change.	35.6
4. The hedge fund threatens to wage a proxy fight in order to gain board representation, or to sue the company for breach of fiduciary duty etc.	8.0
5. The hedge fund launches a proxy contest in order to replace the board.	11.6
6. The hedge fund sues the company.	3.6
7. The hedge fund intends to take control of the company, for example, with a takeover bid.	3.2

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Hedge funds' capital commitment and investment horizon

	Hedge Funds' Invested Capital							
	Full Sample				Hostile Subsample			
	Initial		Max		Initial		Max	
	Percent Ownership	Invested Cap' (in $1m)	Percent Ownership	Invested Cap' (in $1m)	Percent Ownership	Invested Cap' (in $1m)	Percent Ownership	Invested Cap' (in $1m)
5th	5.0	1.4	5.1	2.0	3.1	1.7	5.0	2.4
25th	5.4	5.4	6.7	7.0	5.4	5.4	7.3	8.2
Median	6.6	15.2	9.4	20.1	6.7	17.0	9.8	24.2
75h	9.8	55.3	14.2	71.9	9.6	57.7	14.8	86.2
95th	23.9	384.0	33.8	468.3	19.8	492.4	34.7	604.9
Average	9.5	89.6	12.9	115.9	8.6	105.0	13.6	149.4
N	4246.0	3820.0	4017.0	3616.0	911.0	848.0	836.0	782.0

Hedge Funds' Investment Horizon (in days)		
	Full Sample	Hostile Subsample
5th	20	24
25th	99	90
Median	262	212
75th	616	477
95th	1976	1421
Average	532	409
Not completed or no data on completion	625	54
Total number of completed events	4032	1002

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Which Firms Are Targeted?

- Firm size (small/mid cap)

- Low relative valuation (e.g., M/B)

- Poor long term stock returns

- Excess cash but low payout, high diversification (Jensen's free cash flow problem)

- Inefficient governance

- High trading liquidity (ease of building a toehold)

- High institutional ownership

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Short run average abnormal return & turnover (centered on filing date)
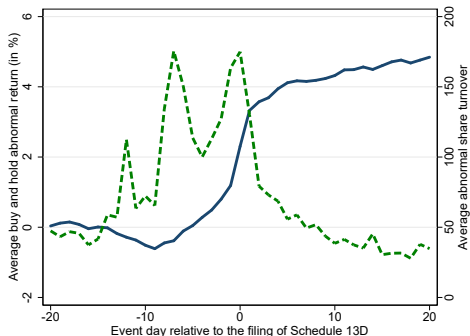
- Average abnormal return of 4%
    - Is it an unbiased price reaction? ⇒ Market efficiency
    - Market timing or information?
    - Wealth transfer? From bondholders, management, employees
- Business strategy related activism and activism with the aim to sell the target generate the highest abnormal return

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Short run abnormal return and turnover

- Distribution of number of days from crossing to filing date

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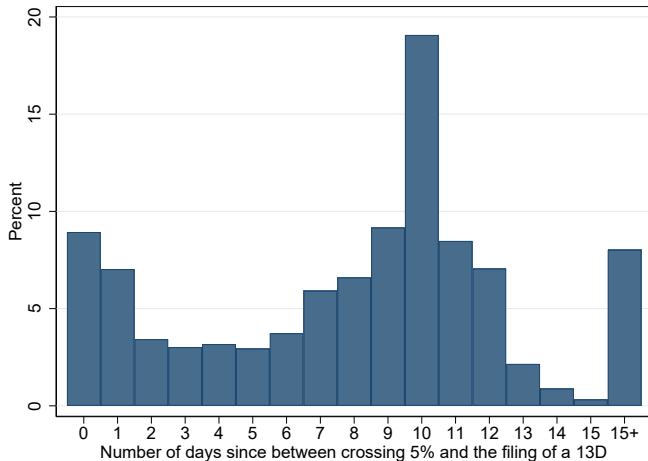
Short run abnormal return and turnover (centered on the trigger date)
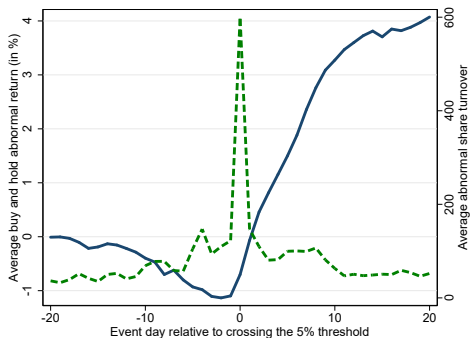

- Trading in the period around the filing (Collin-Dufresne and Fos (2015), Mihov (2016), Gantchev and Jotikasthira (2018), Wong (2020), Cookson, Fos, Niessner (2021))
- Di Maggio, Franzoni, Kermani, and Sommavilla (2019), "The Relevance of Broker Networks for Information Diffusion in the Stock Market."

  "we show that the clients of the broker employed by activist investors to execute their trades tend to buy the same stocks just before the filing of the 13D."

  "managers with the strongest relationships with central brokers capture, on average, higher excess returns per trade."

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Short run abnormal return and turnover

- The previous evidence on short run abnormal return and turnover is common to other filers. Schnitzler and von Lilienfeld-Toal (2019), Figure 3:

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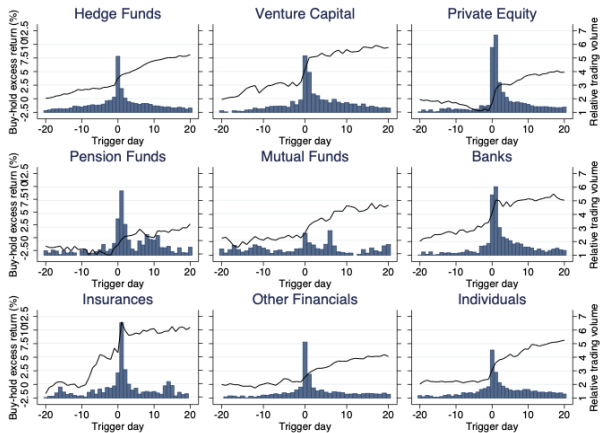
Short run abnormal return and turnover centered around activists' exit
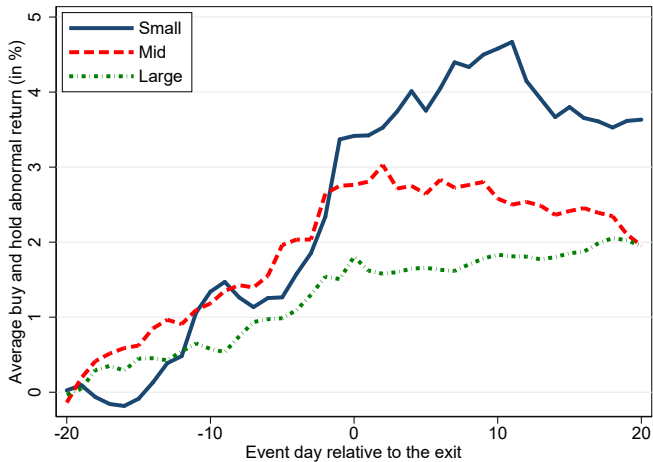
Long-term average abnormal returns

- Value weight calendar-time portfolio regressions:

$$r_t - r_f = \alpha + \beta_{RMRF} RMRF_t + \beta_{SMB} SMB_t + \beta_{HML} HML_t + \beta_{RMW} RMW_t$$
$$+ \beta_{CMA} CMA_t + \beta_{MOM} MOM_t + \varepsilon_t$$

Panel A: Value-weighted target firm six-factor regressions
Holding period (in months)

VARIABLES	(1) -36 to -25	(2) -24 to -13	(3) -12 to -1	(4) +1 to +12	(5) +13 to +24	(6) +25 to +36
α	-0.008	-0.010	-0.012	-0.000	0.001	0.004
	(-3.819)	(-4.579)	(-5.124)	(-0.132)	(0.606)	(1.868)
β_{RMRF}	1.008	1.125	1.004	0.981	1.072	0.897
	(17.506)	(14.024)	(14.829)	(17.956)	(20.860)	(16.591)
β_{SMB}	0.404	0.398	0.230	0.465	0.422	0.422
	(4.661)	(4.728)	(2.078)	(6.448)	(6.895)	(4.827)
β_{HML}	-0.161	-0.274	0.057	-0.052	-0.005	0.041
	(-1.695)	(-2.218)	(0.556)	(-0.515)	(-0.063)	(0.509)
β_{RMW}	-0.114	0.321	0.305	0.345	0.245	-0.169
	(-0.956)	(3.339)	(2.318)	(3.511)	(3.482)	(-1.596)
β_{CMA}	0.251	0.120	0.019	0.229	0.054	0.081
	(1.976)	(0.736)	(0.135)	(1.714)	(0.540)	(0.696)
β_{MOM}	-0.033	-0.112	-0.113	-0.129	-0.006	0.091
	(-0.783)	(-1.794)	(-1.239)	(-2.551)	(-0.137)	(1.981)
N	300	300	301	298	292	280
R^2	0.690	0.706	0.594	0.694	0.763	0.694

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Long-term average abnormal returns (small cap target firms)

Panel B: Value-weighted small target firms six-factor regressions
Holding period (in months)

VARIABLES	(1) -36 to -25	(2) -24 to -13	(3) -12 to -1	(4) +1 to +12	(5) +13 to +24	(6) +25 to +36
α	0.003	-0.002	-0.004	0.001	0.001	0.002
	(1.268)	(-1.107)	(-2.064)	(0.574)	(0.458)	(0.955)
β_{RMRF}	0.890	0.809	0.887	0.820	0.877	0.941
	(13.526)	(14.159)	(14.304)	(11.923)	(10.949)	(13.530)
β_{SMB}	0.910	0.974	0.774	0.789	1.070	0.976
	(10.794)	(13.648)	(11.193)	(10.872)	(10.632)	(11.052)
β_{HML}	0.308	-0.043	0.093	0.086	-0.009	0.170
	(2.468)	(-0.376)	(0.600)	(0.647)	(-0.051)	(1.315)
β_{RMW}	-0.129	0.001	0.067	0.099	0.077	0.178
	(-1.222)	(0.007)	(0.667)	(0.872)	(0.495)	(1.540)
β_{CMA}	0.078	0.224	0.077	-0.058	0.067	-0.196
	(0.473)	(1.625)	(0.546)	(-0.402)	(0.358)	(-1.195)
β_{MOM}	-0.331	-0.345	-0.221	-0.238	-0.280	-0.202
	(-4.386)	(-5.146)	(-4.515)	(-3.938)	(-3.547)	(-3.218)
N	292	292	293	292	286	273
R^2	0.750	0.758	0.707	0.633	0.681	0.730

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Long-term average abnormal returns (large cap target firms)

Panel C: Value-weighted large target firms six-factor regressions
Holding period (in months)

VARIABLES	(1) -36 to -25	(2) -24 to -13	(3) -12 to -1	(4) +1 to +12	(5) +13 to +24	(6) +25 to +36
α	-0.009	-0.010	-0.013	0.000	0.001	0.003
	(-4.138)	(-4.449)	(-5.994)	(0.017)	(0.433)	(1.581)
β_{RMRF}	1.026	1.124	1.034	1.000	1.088	0.868
	(16.446)	(13.247)	(15.763)	(17.621)	(20.306)	(15.635)
β_{SMB}	0.402	0.374	0.194	0.435	0.382	0.455
	(4.328)	(4.251)	(1.689)	(5.839)	(5.934)	(5.148)
β_{HML}	-0.205	-0.261	0.065	-0.034	0.010	0.014
	(-2.054)	(-1.966)	(0.619)	(-0.327)	(0.134)	(0.180)
β_{RMW}	-0.098	0.312	0.302	0.339	0.249	-0.187
	(-0.784)	(2.922)	(2.256)	(3.382)	(3.392)	(-1.752)
β_{CMA}	0.267	0.099	0.047	0.247	0.062	0.121
	(2.059)	(0.585)	(0.333)	(1.768)	(0.577)	(1.049)
β_{MOM}	-0.025	-0.104	-0.105	-0.120	0.009	0.072
	(-0.568)	(-1.591)	(-1.108)	(-2.286)	(0.195)	(1.591)
N	290	290	297	292	289	275
R^2	0.690	0.695	0.608	0.683	0.750	0.689

- Find insignificant alphas post activists' exit
  - Corroborating evidence: Clifford (2008), Becht, Franks, Grant, Wagner (2017), Foroughi, Kang, Ozik, Sadka (2019), Swanson, Young, Yus (2022)

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Target firm long-term performance (Q and ROA)

Panel A: The p-score-matched sample				
	(1)	(2)	(3)	(4)
VARIABLES	Q	Q	ROA	ROA
$d \cdot t - 3$	0.0809*	0.0165	0.0046	0.0030
	(1.65)	(0.35)	(1.21)	(0.85)
$d \cdot t - 2$	0.0460	0.0121	-0.0044	-0.0043
	(1.19)	(0.33)	(-1.63)	(-1.64)
$d \cdot t$ Event Year	0.1137***	0.1099***	-0.0038	-0.0036
	(2.92)	(2.81)	(-1.41)	(-1.31)
$d \cdot t + 1$	0.1966***	0.1829***	-0.0024	0.0017
	(3.94)	(3.77)	(-0.62)	(0.46)
$d \cdot t + 2$	0.1633***	0.2119***	-0.0019	0.0026
	(2.75)	(3.83)	(-0.42)	(0.65)
$d \cdot t + 3$	0.2296***	0.2670***	0.0055	0.0102**
	(3.47)	(4.29)	(1.06)	(2.26)
$d \cdot t + 4$	0.2277***	0.2650***	0.0086	0.0152***
	(3.21)	(3.93)	(1.53)	(3.12)
$d \cdot t + 5$	0.3174***	0.3281***	0.0024	0.0112**
	(4.11)	(4.63)	(0.38)	(2.08)
$\ln(MV)$	0.2435***	0.7038***	0.0339***	0.0441***
	(18.70)	(25.54)	(27.52)	(21.99)
$\ln(Age)$	-0.2747***	-0.2486***	0.0206***	0.0067
	(-9.25)	(-4.53)	(8.01)	(1.64)
$t + k$ Dummies	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
SIC3 FE	Yes	No	Yes	No
Firm FE	No	Yes	No	Yes
N	42060	42060	42060	42060
R^2	0.232	0.631	0.355	0.763

Panel B: The deterioration-matched sample				
	(1)	(2)	(3)	(4)
VARIABLES	Q	Q	ROA	ROA
$d \cdot t - 3$	0.1169*	-0.0248	-0.0026	0.0044
	(1.88)	(-0.42)	(-0.59)	(1.13)
$d \cdot t - 2$	0.0511	-0.0276	-0.0084**	-0.0037
	(0.97)	(-0.58)	(-2.44)	(-1.24)
$d \cdot t$ Event Year	0.0037	0.0800*	0.0009	-0.0026
	(0.08)	(1.79)	(0.28)	(-0.92)
$d \cdot t + 1$	0.1511**	0.2149***	0.0064	0.0052
	(2.54)	(3.73)	(1.47)	(1.32)
$d \cdot t + 2$	0.1188*	0.2392***	0.0092*	0.0055
	(1.75)	(3.71)	(1.79)	(1.22)
$d \cdot t + 3$	0.1173	0.2524***	0.0116**	0.0099**
	(1.48)	(3.36)	(2.01)	(1.99)
$d \cdot t + 4$	0.2005**	0.3210***	0.0105*	0.0123**
	(2.41)	(4.07)	(1.68)	(2.35)
$d \cdot t + 5$	0.1962**	0.2715***	0.0112*	0.0169***
	(2.08)	(3.24)	(1.65)	(2.95)
$\ln(MV)$	0.2507***	0.7848***	0.0353***	0.0445***
	(18.27)	(23.89)	(25.53)	(17.92)
$\ln(Age)$	-0.3196***	-0.1274**	0.0310***	0.0080**
	(-10.45)	(-2.27)	(11.32)	(2.02)
$t + k$ Dummies	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
SIC3 FE	Yes	No	Yes	No
Firm FE	No	Yes	No	Yes
N	45005	45005	45005	45005
R^2	0.221	0.623	0.366	0.776

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## U.S. Census-based evidence

- Brav, Jiang, and Kim (2015)

  DISCLAIMER: Any opinions and conclusions expressed herein are those of the author(s) and do not necessarily represent the views of the U.S. Census Bureau. All results have been reviewed to ensure that no confidential information is disclosed

  - Census of Manufacturers (CMF) and the Annual Survey of Manufacturers (ASM) to compute measures of productivity, profitability, and product market competition

    - CMF covers all manufacturing plants in the U.S. (public and private) with at least one employee for years ending '2' or '7' (the "Census years"), including roughly 300,000 plants in each census. ASM covers about 50,000 manufacturing plants for the "non-Census years"
    - Plant-year data on total value of shipments, capital stock and investment, labor hours, and material and energy costs

  - Longitudinal Business Database (LBD). Unique firm-plant links. Can follow plants independent of ownership changes

    - Number of employees, annual payroll, industry classifications, geographical location, and ownership status

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U.S. Census-based evidence. Changes in total factor productivity

① Activism is associated with gains in productivity at target plants
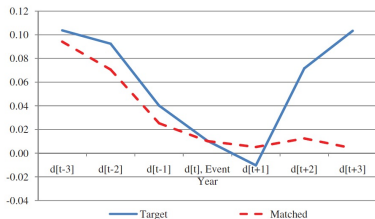
Figure 2
Placebo test: Target plants vs. plants matched on preintervention deterioration
Figure 2 plots two sets of estimated coefficients on $d[t+k]$, $k = -3, \ldots, +3$, where t is the year of intervention, as in Regression (2) (see Table 4). The two graphs represent (i) plants in targeted firms that have matched plants (solid line), and (ii) nonevent plants matched by similar declines in TFP from $t-3$ to t in the same industry and year as the targeted plants (dashed line).

– TFP is the residual from a log-linear Cobb-Douglas production function estimated by year and industry

② Redeployment of capital is a common stated goal of activist hedge funds. Plants that were sold subsequent to the intervention experience a substantial improvement in the hands of the new owners relative to the matched plant sample

③ Attrition and the direction of a ''delisting bias''?

④ Targets invest less in IT than their peers prior to the arrival of activists but three years afterwards their IT reaches that of peers. Increases in both labor productivity and wages are more pronounced in industries for which IT is more important

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Hedge fund activism and corporate innovation

- How does hedge fund activism reshape corporate innovation?
    - Brav, Jiang, Ma, Tian (2018), He, Qiu, and Tian (2020)
    - Arguably the most important long-term investment that firms make but also the most susceptible to short-termism

- Larry Fink, Blackrock's Chairman and CEO:

    ▶ "Delivering Long-Term Value - Letter to Corporates, March 31, 2015
    "...in response to the acute pressure, growing with every quarter, for companies to meet short-term financial goals at the expense of building long-term value. This pressure originates from a number of sources–the proliferation of activist shareholders seeking immediate returns,..."

    ▶ His February 1, 2016 Letter to CEOs:
    "Those activists who focus on long-term value creation sometimes do offer better strategies than management. In those cases, BlackRock's corporate governance team will support activist plans. During the 2015 proxy season, in the 18 largest U.S. proxy contests (as measured by market cap), BlackRock voted with activists 39% of the time."

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## Hedge fund activism and corporate innovation

- Dynamics in innovation, as measured by the number of patents applications and their subsequent lifetime citations, in the years around the targeting by hedge fund activists
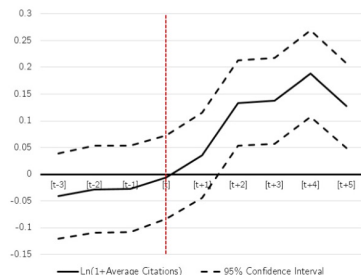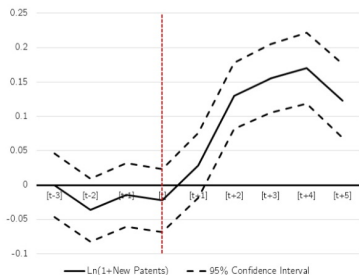
- The figures present estimates representing the differences in trends in innovation between hedge fund targets and propensity score matched control firms
- The left panel plots estimates for the abnormal level of <u>quantity of innovation</u> measured by the logarithm of the number of patents filed by firm i in year t. The right panel plots the estimates for the abnormal level of <u>quality of innovation</u> measured by the logarithm of the average lifetime citations received by patents filed by the firm in year t

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## Hedge fund activism and corporate innovation

- Improvement is driven by firms with a diverse portfolio of patents prior to the intervention that refocused their efforts after the arrival of activists
- Activists push firms to allocate internal innovation capacity to key areas of expertise
- Targets sell an abnormally high number of existing patents compared to their matched firms. Patents sold are less related to their technological expertise. Higher rate of patent transactions matching peripheral patents to new and better-suited owners represents efficient reallocation of innovation outputs
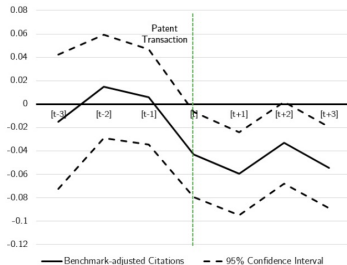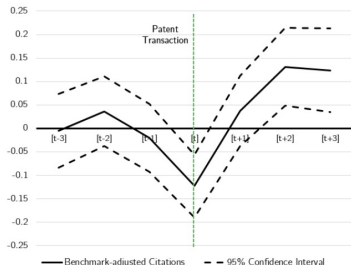
- Inventors retained by target firms are more productive than stayers at non-target peers. Inventors who leave are more productive with their new employers

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Impact on other stakeholders (1)

- Bondholders: Evidence is mixed. The effect largely dpends on characteristics such as the activist's objectives and covenant protections
  - Aslan and Maraachlian (2009), Brav, Jiang, and Kim (2009), Klein and Zur (2011), Sunder, Sunder, and Wongsunwai (2014), Xu and Li (2011), Berndt (2018)

- CEOs: Significantly higher turnover. Keusch (2021):
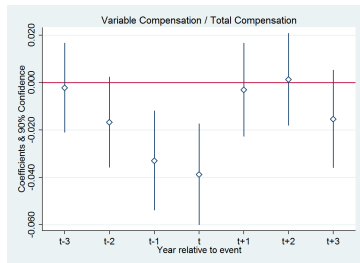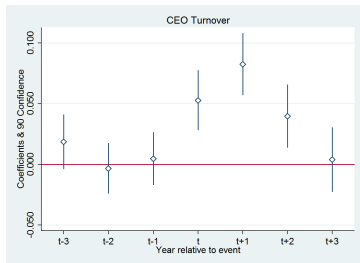
- (i) Large increase in annual CEO turnover, (ii) Pay for performance converges up back to level of control firms, (iii) Increase in total CEO compensation (driven by new hires). Similar evidence in Choi and Gong (2018)).

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Impact on other stakeholders (2)

- Employees of target firms experience stagnation in work hours and wages while their productivity improves
  - The increase in labor productivity is only significant in highly unionized industries
  - Nonproduction ("white collar") workers, who are less likely to be covered by unions, suffer larger wage cuts than production workers do

How the Carl Icahns of the World Benefit Firms but Not Workers, by Walter Frick, October 9, 2015, *Harvard Business Review*

"There are two stories you can tell about finance in America. In the first, the financial sector helps grow the economic pie by shifting resources to the people and firms who can put them to the best use. In the second, Wall Street is capturing value rather than creating it"

"That's the tension between the two accounts of what finance does: it's easy to argue for reining in Wall Street if investors are squeezing workers without creating any value. But activist hedge funds seem to be creating value and capturing a higher percentage of it. Both stories are true at once"

When Workers Began Falling Behind

Until the 1980s labor productivity, real GDP per capita, private employment, and median family income all rose in tandem in the U.S. Then median income started to trail, and around 2000 job growth slowed.

Labor productivity
400

Real GDP per capita

Private employment

Median family income

300

200

1947=100

1950 '55 '60 '65 '70 '75 '80 '85 '90 '95 2000 '05 '10
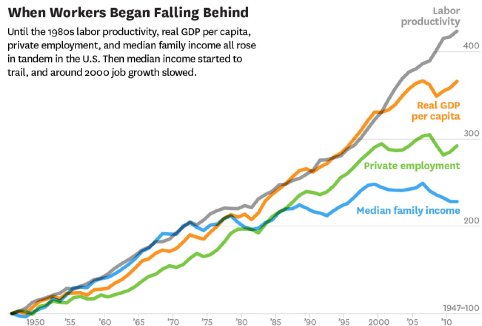
SOURCE FEDERAL RESERVE BANK OF ST. LOUIS; ERIK BRYNJOLFSSON AND ANDREW MCAFEE
FROM "THE GREAT DECOUPLING," JUNE 2015
© HBR.ORG

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Tests for causality

- We are interested in the question whether the target firm's performance would have changed had it not been for the HFs' effort (rather than whether HF activism affects firm performance if funds were assigned randomly to targets)

    - An IV for exogenous termination of HF intervention would help, but it is not necessary to show the conditional treatment effect
    - The conventional IV approach which is predicated on finding exogenous shocks in targeting is not applicable – even if there are exogenous shocks that make targeting easier, HFs are still going to select among candidates that are now made easier to be targeted

- From earlier work we know that activists tend to hold concentrated stakes in target firms for an average holding period of two years. Undiversified positions together with costly engagements cannot be justified based on a pure stock picking story (Gantchev (2013))

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Tests for causality

1. Target would have "self-cured" even in the absence of activist hedge funds
   - Brav, Jiang, and Kim (2015) define "events" as firms that are not targeted but experience a similar deterioration in productivity as the target firms
   - Brav, Jiang, Ma, and Tian (2018) conduct similar analysis on patenting activity and counterfactuals to the evolution of patent citations after patent sales

2. Focus on hostile activist interventions
   - Confrontational events account for a quarter of the sample. Involve actual or threatened proxy contests or law suits and shareholder campaigns of a confrontational nature

3. Hedge funds are targeting firms best positioned to benefit from positive industry shocks (e.g., consolidation)
   - Brav, Jiang, and Kim (2015) look at real effects on plants that belong to primary vs. non-primary segments of target

4. Hedge funds have superior ability to select targets ("stock-picking") that are expected to experience positive changes
   - Look at hedge funds switching from a Schedule 13G, filed for passive investment, to a Schedule 13D. Benchmarked to hedge funds' filing of Schedule 13Gs.
     $\Rightarrow$ 13D (stock picking + potential intervention) vs. 13G (stock picking only)

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1. Impact of institutional investors on activism (Appel, Gormley, and Keim (2016), Egrican (2020), Kedia, Starks, and Wang (2021), Brav, Jiang, Li, and Pinnington (2021))

2. The threat of activist investors an external disciplining force (Zhu (2014), Gantchev, Gredil, and Jotikasthira (2017), Feng, Xu, and Zhu (2016), Maier (2018), Maffett, Nakhmurina, and Skinner (2021))

3. Cross-sectional differences and time-series variation in activist interventions. Implications for objectives, tactics, and outcomes (Burkart and Dasgupta (2015), Krishnan, Partnoy, and Thomas (2016), Francis, Shen and Wu (2017))

4. Organizational structure of the fund and hedge fund manager characteristics (Kang, Ozik, Sadka (2018), Reynolds (2016), Strobl and Zeng (2018), Brick, Chen, Kang, and Kim (2019))

5. Target board of directors (Gow, Shin, and Srinivasan (2016), Bebchuk, Brav, Jiang, Keusch (2019), Chu and Zhao (2020), Yavuz (2021), Balogh (2021))

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⑥ Target firm's response (Boyson and Pichler (2018), Chen, Francis, Shen, and Wu (2020)

⑦ Efficiency of target firms' investment and internal capital markets (Kim (2020), Singh, Deb, and Singh (2019), Ahn, Kim, and Kwon (2021))

⑧ Impact on corporate asset markets. Transaction volumes, real asset liquidity, transaction prices, and economic efficiency gains (Hege and Zhang (2019), Guo, Shemesh, Utham, and Wang (2019))

⑨ "Wolf Packs" (Gonzalez and Calluzzo (2018), Wong (2019), Brav, Dasgupta, and Mathews (2018), He and Li (2018))

⑩ Voice and Exit (Levit (2018), Edmans, Levit and Reilly (2019), Fos and Kahn (2019))

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11 Impact on rival firms and supply-chain effects (Aslan and Kumar (2016), Aslan (2020))

12 Activists' role in the market for corporate control (Greenwood and Schor (2009), Jiang, Li, Mei (2016), Boyson, Gantchev, Shivdasani (2016), Corum and Levit (2019), Wu and Chung (2019), Gantchev, Sevilir, Shivdasani (2019))

13 Interaction with sell-side analysts (Chen and Shofi (2018))

14 The role of liquidity in block formation (Collin-Dufresne and Fos (2015, 2016), Mihov (2016), Gantchev and Jotikasthira (2017), Back, Collin-Dufresne, Fos, Li, and Ljuungqvist (2018), Fos and Kahn (2019))

15 Activist use of derivatives and the flow of private information into stock and option prices (Collin-Dufresne, Fos, and Muravyev (2019))

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16. Activist impact on target firm leverage (Singh, Deb, and Singh (2020))

17. Activist impact on target firm employees (Brav, Jiang, Kim (2015), Agrawal and Lim (2019))

18. Activist intervention in REITs (Downs, Straska, and Waller (2018))

19. Activists' experience and reputation (Zur (2009), Krishnan, Partnoy, and Thomas (2016), Johnson and Swem (2018), Boyson, Ma, and Mooradian (2019))

20. Settlements (Bebchuk, Brav, Jiang, and Thomas (2019), Corum (2018), Schoenfeld (2020))

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21 Role of the media (Wang and Wu (2020))

22 Accounting conservatism, Auditors, disclosure, and related policies (Cheng, Huang, Li and Stanfield (2012), Cheng, Huang, and Li (2014), Khurana, Li and Wang (2017), Bourveau and Schoenfeld (2017))

23 Activists' impact on banks and mortgage lending. Roman (2015), Chu, Huang, and Zhang (2019)

24 Activists' impact on the environment (toxic chemical emissions). Chu and Zhao (2019) and Akey and Appel (2019)

25 Political influence in hedge fund activism. An and Huang (2021)

26 Causality (Pezier (2019), Albuquerque, Fos, Schroth (2020))

Policy Implications

▶ The SEC has recently announced (Feb. 2022) proposed rule amendments to modernize reporting of beneficial ownership

- The amendments would accelerate the filing deadline for Schedule 13D reports from 10 days to five days. Require amendments be filed within one business day
- Expand the application of the regulation to certain derivative securities
- Clarify the circumstances under which two or more persons have formed a "group" that would be subject to beneficial ownership reporting obligations
- Similar to early attempts at federal anti-activist legislation (the "Brokaw Act")
  - Related papers by Bebchuk and Jackson (2012), Bebchuk, Brav, Jackson and Jiang (2013), Brav, Heaton, and Zandberg (2018), Ordonez-Calafi and Bernhardt (2021)

▶ State level legislation of activists

- "Bring Business to Texas & Fairness in Disclosure Act"

▶ Use of poison pills against activist shareholders (Kahan and Rock (2017))

Summary

- Hedge fund activism is welcomed by shareholders. Positive price reaction with no evidence of subsequent correction

- Positive real effect on the fundamentals of targeted companies relative to propensity score matched firms. Gains mostly come from value creation rather than a wealth transfer

- Inconsistent with the view that hedge fund activists are focused on short-term financial engineering schemes

- Hedge fund activism is a market approach to corporate governance without seeking control