



Institute for governance  
of private and public organizations

# Hedge Fund Activism : Preliminary Results and Some New Empirical Evidence

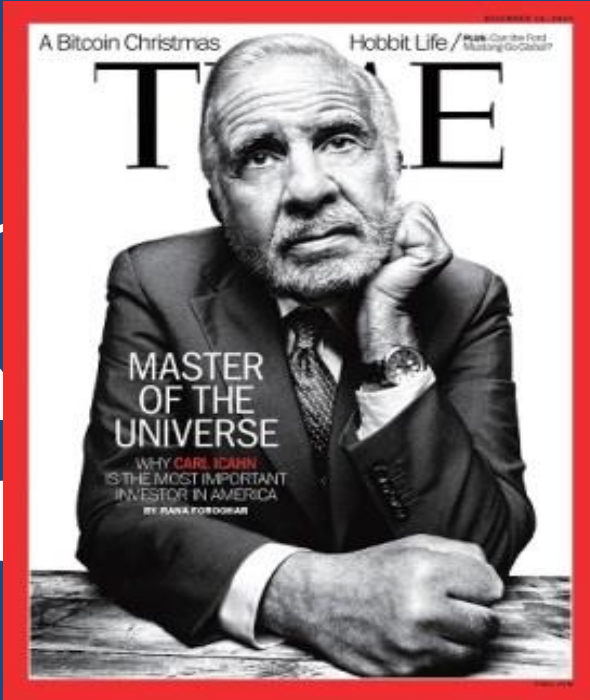
**Presentation by Professor Yvan Allaire Ph.D. (MIT), FSRC**

**Executive Chair, IGOPP**

April 1<sup>st</sup> 2015

Hedge fund activism has  
good press and gained  
supporters over recent years

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The Economist

# Shareholder activism Capitalism's unlikely heroes

Why activist investors are good for the public company  
Feb 7th 2015 | From the print edition

AS INVENTIONS go, the public company is one of capitalism's greatest. Initial public offerings promote innovation, by providing an exit route for entrepreneurs; and ordinary people have a chance to invest in capitalism's wealth-creating machines.



THE HEAD OF THE BOARD SMASHING BARBARIAN AT THE GATE YOU THINK HE IS?

39 GIFT IDEAS FOR THE EXEC IN YOUR HOUSE p.80

DEREK DECLOET NAMES HIS OWN CEO OF THE YEAR p.32

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# Activist funds An investor calls

Sometimes ill mannered, speculative and wrong, activists are rampant. They  
will change American capitalism for the better  
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GATE YOU  
THINK HE IS?

DECEMBER 2012

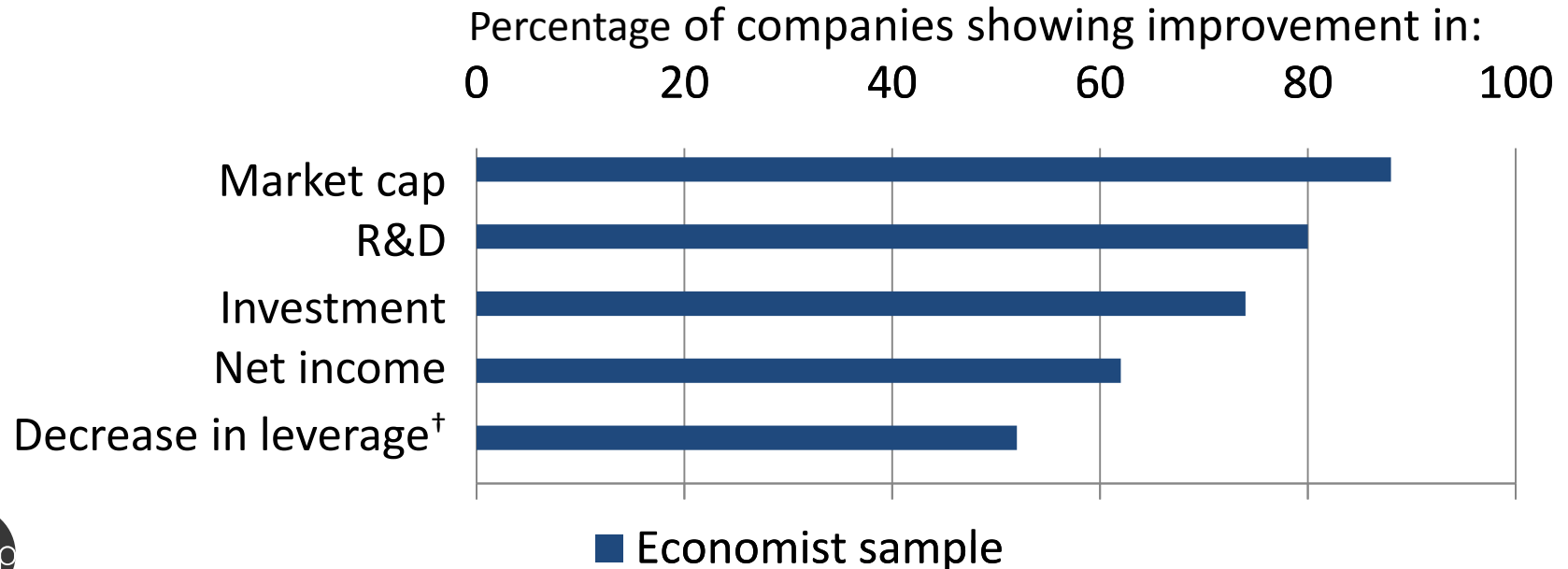


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# The Economist: empirical case for the good performance of activist hedge funds

Performance from Q4 2009 to Q3 2014 for 50 selected interventions

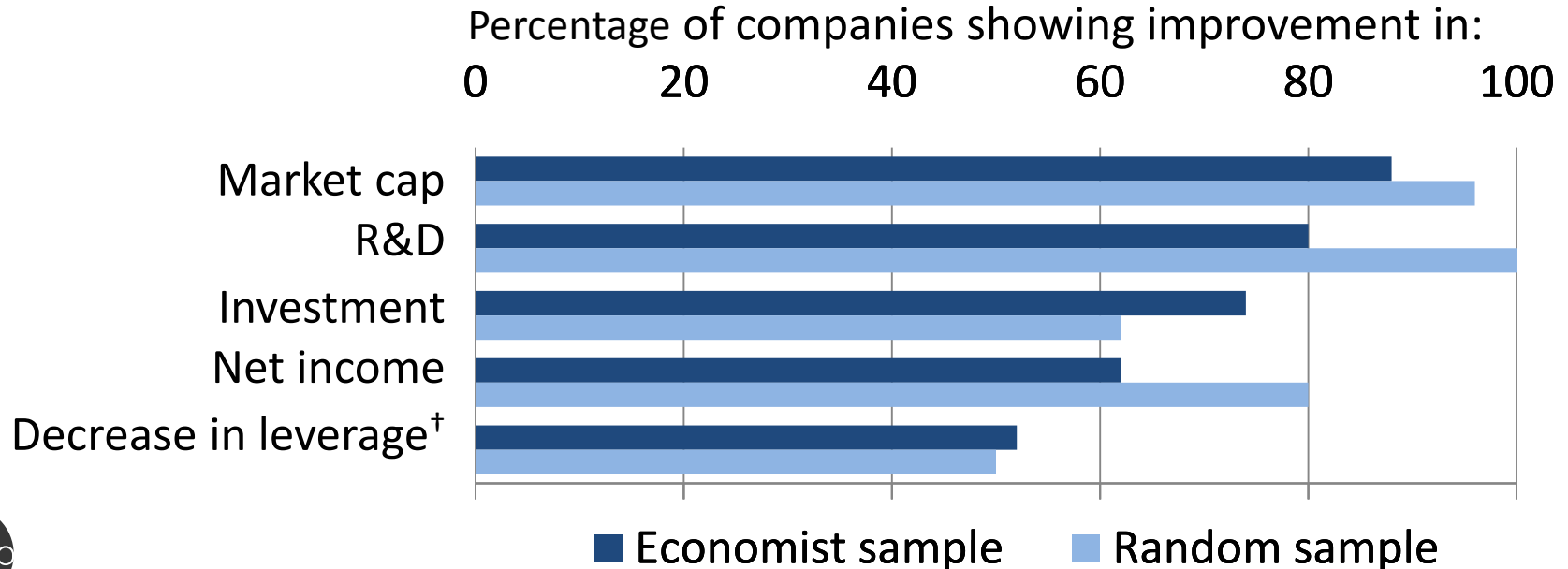


<sup>†</sup> Excluding financial companies



# The Economist: empirical evidence: comparison with a random sample of companies

Performance from Q4 2009 to Q3 2014



<sup>†</sup> Excluding financial companies





# Picking a sample of hedge fund activism: not so simple and has large impact on results

- There is no shared definition of what is an “activist hedge fund”;
- Some firms are targeted by several different funds in the same year;
- When does an intervention begin? From the time of announcement/13D filing? From the time the firm accedes to the demands of the hedge fund? From the time that the demands are actually implemented? These different dates for the “intervention” would result in very different performance results.

# Different studies... different number of activist campaigns!

Authors, studies, compilations	2005	2006	2007	2008	2009	2010	2011	2012	2013
Bebchuk, Brav and Jiang (2014)	237	269	272						
Brav, Jiang and Kim (2012)	234	252	208						
Brav, Jiang and Kim (2013)	210	259	297	259	136	169	156		
Gantchev (2013)	191	227	284						
Klein and Zur (2011)	98	101							
Gow, Shin and Srinivasan (2014)	199	316	368	336	158	201	172	118	
Greenwood and Schor (2009)	153	137							
Boyson, Linlin and Mooradian (2015)	256	290	354	267	152	220	188	201	233
<b>WSJ-FactSet Activism Scorecard</b>	<b>172</b>	<b>306</b>	<b>353</b>	<b>353</b>	<b>230</b>	<b>219</b>	<b>242</b>	<b>262</b>	<b>271</b>



# Our sample

**We used the**  
*Wall Street Journal/FactSet Activism Scorecard*  
**as a point of departure and then dug**  
**into the data**



# First, we isolated campaigns actually carried out by hedge funds

	2005	2006	2007	2008	2009	2010	2011	2012	2013
<b>WSJ-FactSet Activism Scorecard</b>	<b>172</b>	<b>306</b>	<b>353</b>	<b>353</b>	<b>230</b>	<b>219</b>	<b>242</b>	<b>262</b>	<b>271</b>
<i>Eliminate Campaigns by Other Types:</i>									
Individuals	(11)	(29)	(41)	(39)	(41)	(22)	(25)	(34)	(21)
Labor Unions	0	(1)	(4)	(1)	(2)	(2)	(5)	(1)	0
Corporations	(1)	(4)	(5)	(5)	(2)	(3)	(2)	(1)	(2)
Public Pension Funds	0	(1)	0	0	0	(2)	(1)	(1)	0
Other Block Holders	(13)	(33)	(35)	(48)	(44)	(31)	(23)	(37)	(38)
Mutual Fund Managers	(2)	(1)	(4)	(1)	(2)	0	(3)	(2)	(1)
<b>Campaigns by hedge funds</b>	<b>145</b>	<b>237</b>	<b>264</b>	<b>259</b>	<b>139</b>	<b>159</b>	<b>183</b>	<b>186</b>	<b>209</b>



Then, we eliminated the effect of multiple campaigns against a given firm as well as campaigns against closed-end funds

	2005	2006	2007	2008	2009	2010	2011	2012	2013
<b>Campaigns by hedge funds</b>	<b>145</b>	<b>237</b>	<b>264</b>	<b>259</b>	<b>139</b>	<b>159</b>	<b>183</b>	<b>186</b>	<b>209</b>
Target is a closed-end fund	(12)	(15)	(17)	(15)	(30)	(22)	(29)	(7)	(14)
Multiple campaigns against a single target	(17)	(31)	(20)	(31)	(9)	(22)	(9)	(24)	(30)
<b>Unique targets</b>	<b>116</b>	<b>191</b>	<b>227</b>	<b>213</b>	<b>100</b>	<b>115</b>	<b>145</b>	<b>155</b>	<b>165</b>

# Importance of the sampling method

- As a result of these eliminations, the sample of hedge fund interventions shrink by 40%-45%; for 2010, the sample shrinks from 219 to 115!
- As previous studies tend to use a sample with a number of cases close to the *WSJ-FactSet Activism Scorecard* methodology, their results must be interpreted with caution.

# The IGOPP study: All U.S. interventions by hedge funds in 2010

	Number of cases
• Targeted firms	115
• Activist hedge funds	98

- Results were compared to a *random sample* of 115 firms matched for market capitalization and industry classification.



# Objectives publicly disclosed

Stated objective by the activist hedge fund	% of cases
<b>Sell the company or asset restructuring (spin-offs, REIT, split)</b>	<b>31.3%</b>
<b>Governance structure or board change</b>	<b>25.2%</b>
<b>Change in payout policy (share repurchase, dividend increase)</b>	<b>16.5%</b>
<b>Cost reduction</b>	<b>7.8%</b>
Other	14.0%
Undisclosed or vaguely described	5.2%



# How they get what they want...



# Success of activist campaigns

	n	% of sample
Partially or completely achieved the stated objectives	87	75.7%
Failed to achieve the stated objectives	28	24.3%

# Activists on Board

**69**

**directors**

represented the activists on the board of

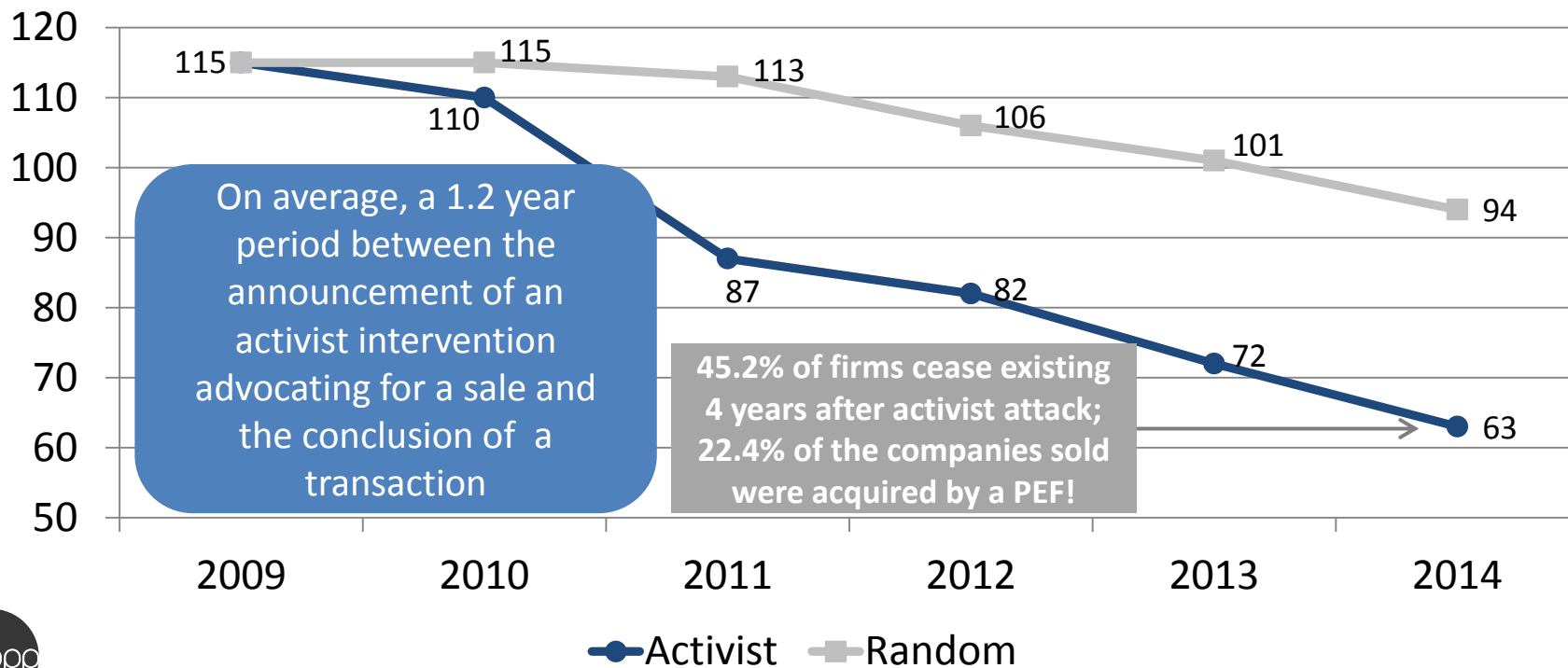
**42 of 115**

**targeted firms (36.5%)**



# Number of firms at year end

(after mergers, companies sold, liquidations and bankruptcies)

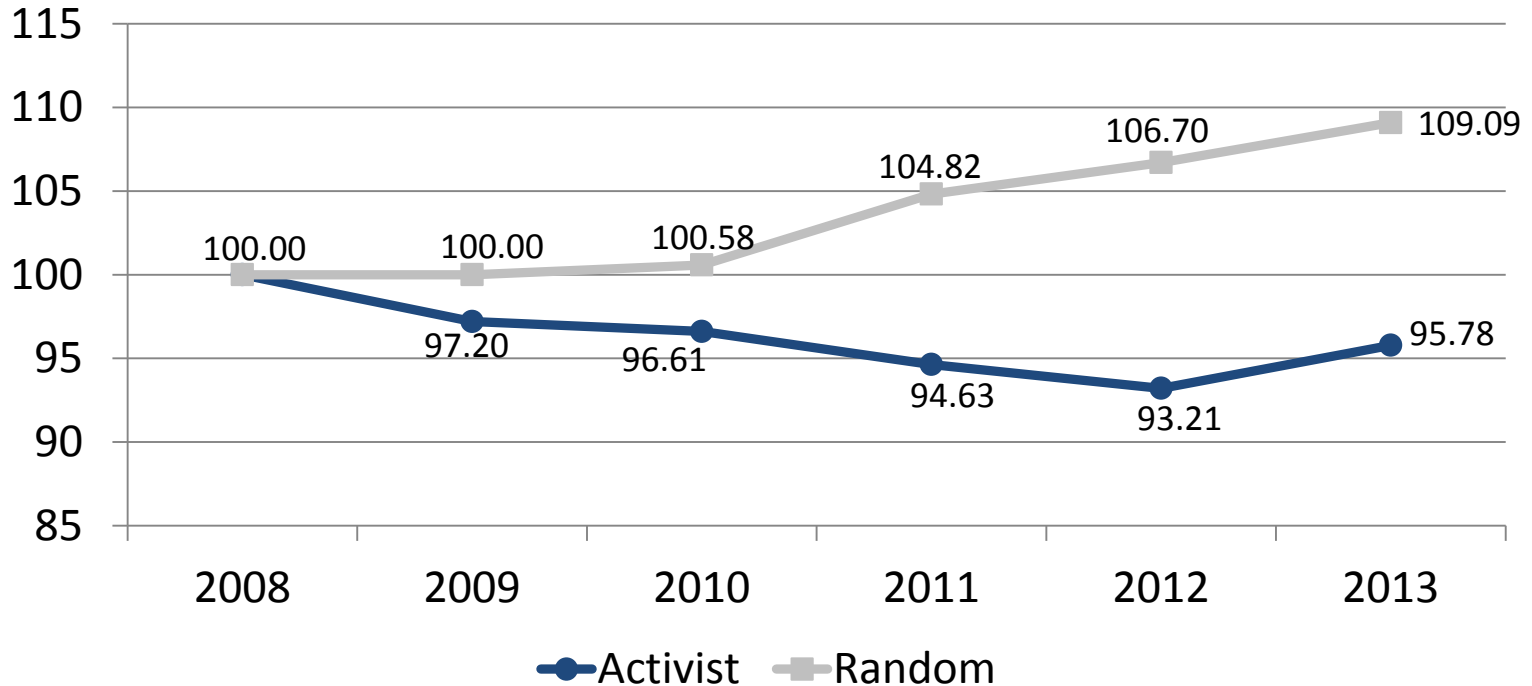


# Long-term shareholders?

Centile	Full sample Holding after announcement (days)
25 <sup>th</sup>	203
<b>50<sup>th</sup></b>	<b>423</b>
75 <sup>th</sup>	806
90 <sup>th</sup>	1,361

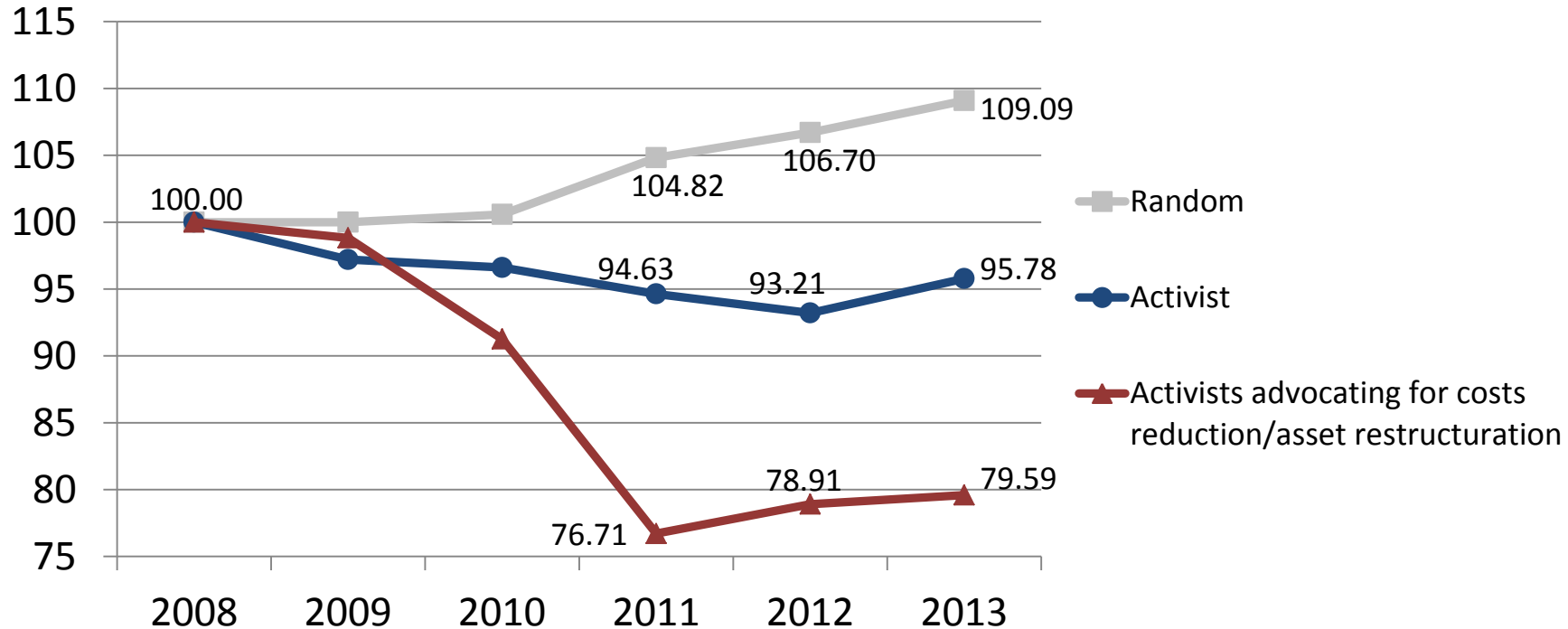
# Employees (2008 = 100)

## Median results

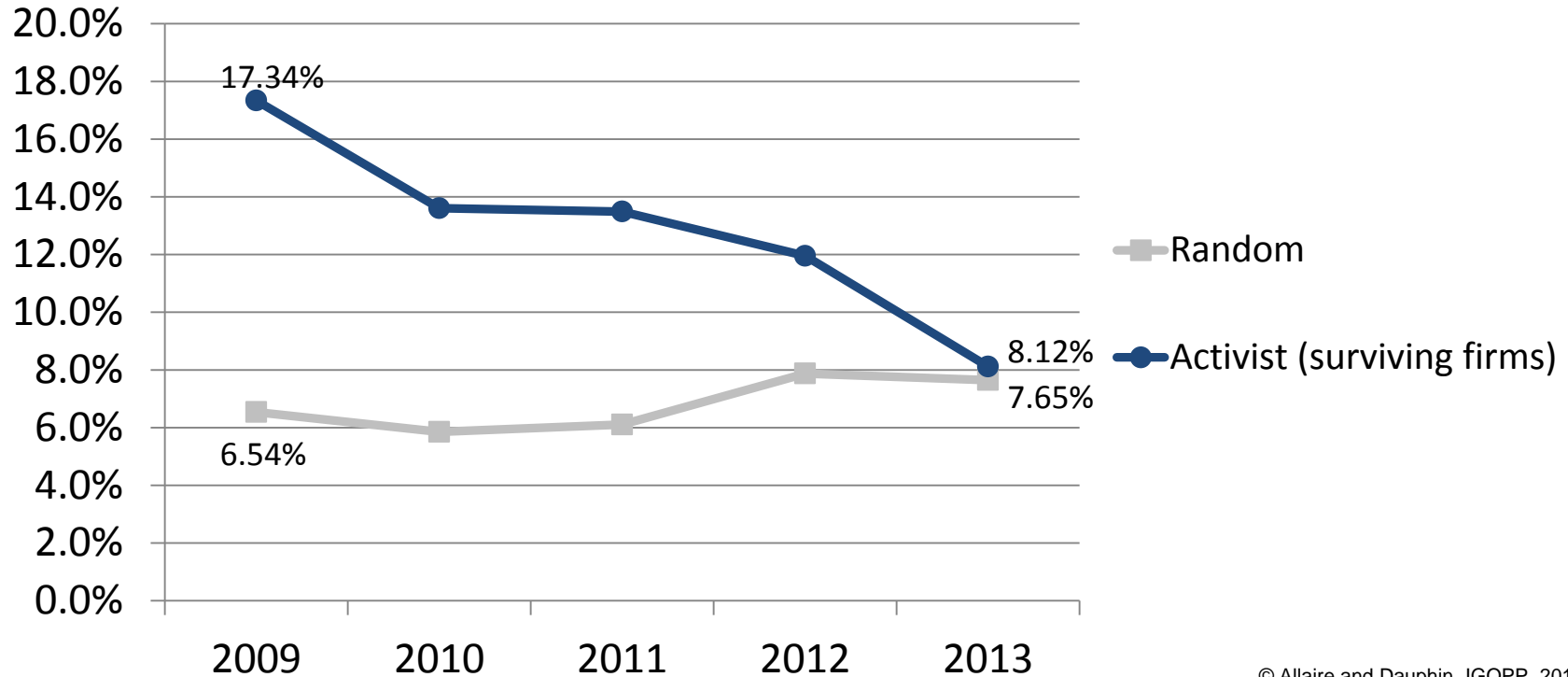


# Employees (2008 = 100)

## Median results

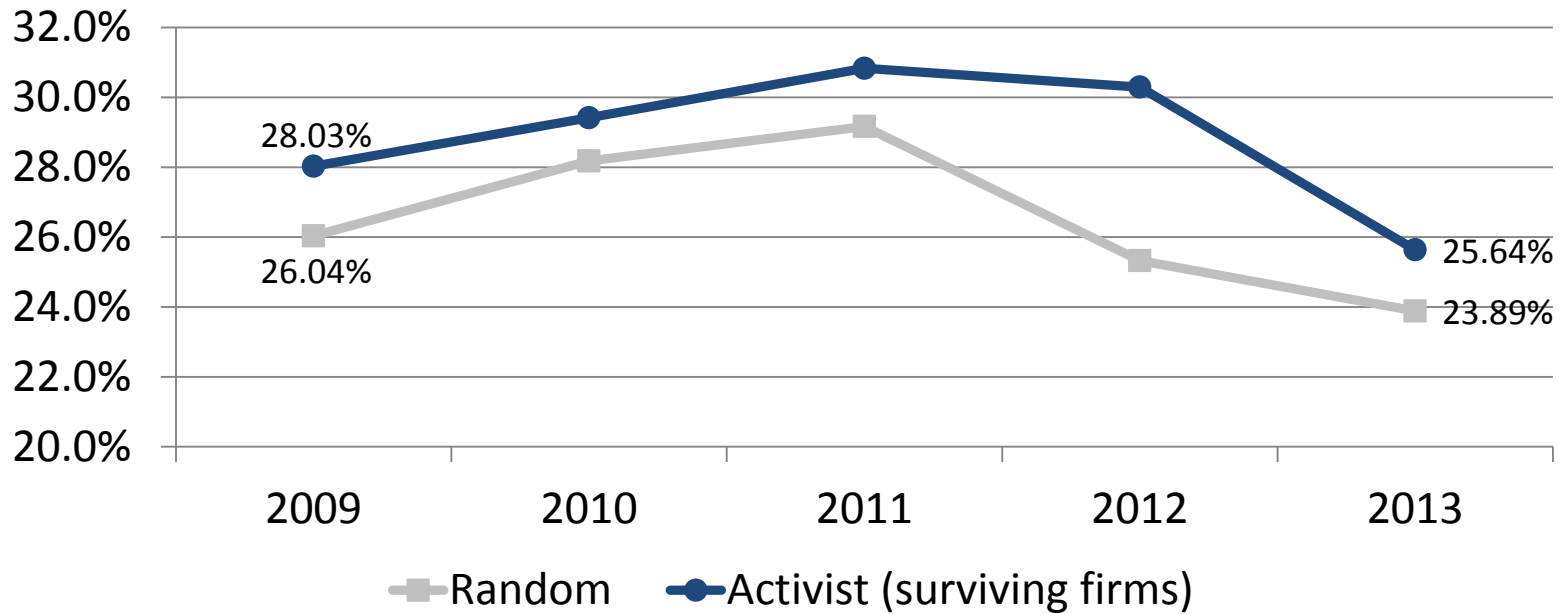


# Evolution of R&D expenses in % of sales

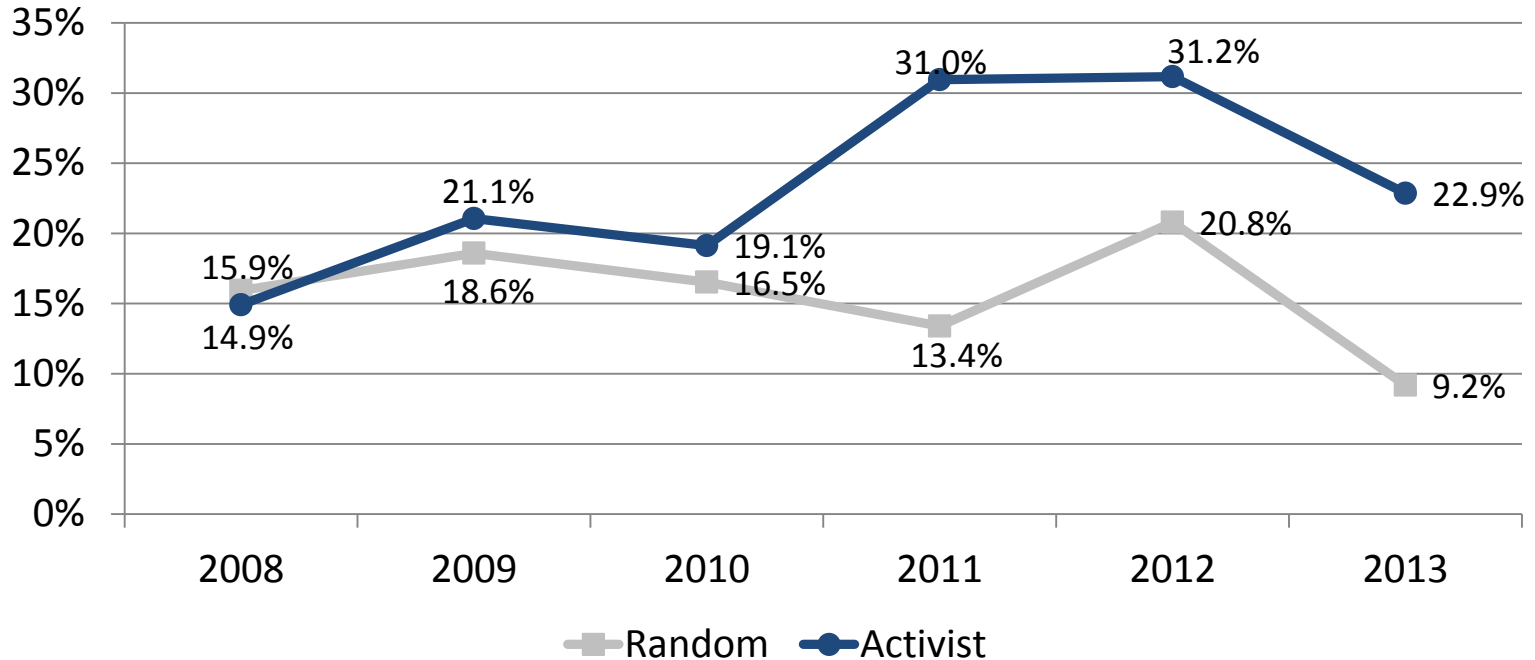




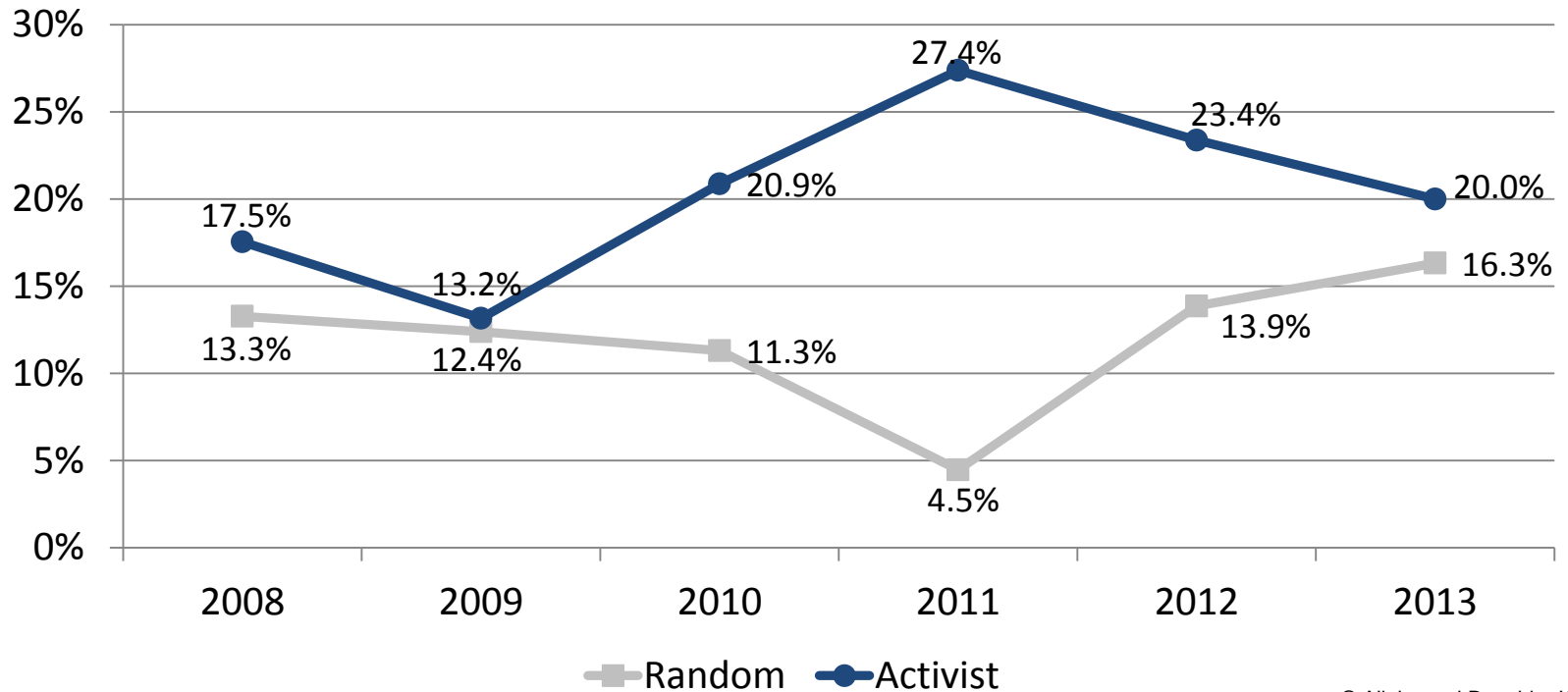
# Evolution of SG&A expenses in % of sales



# Turnover rate for CFOs

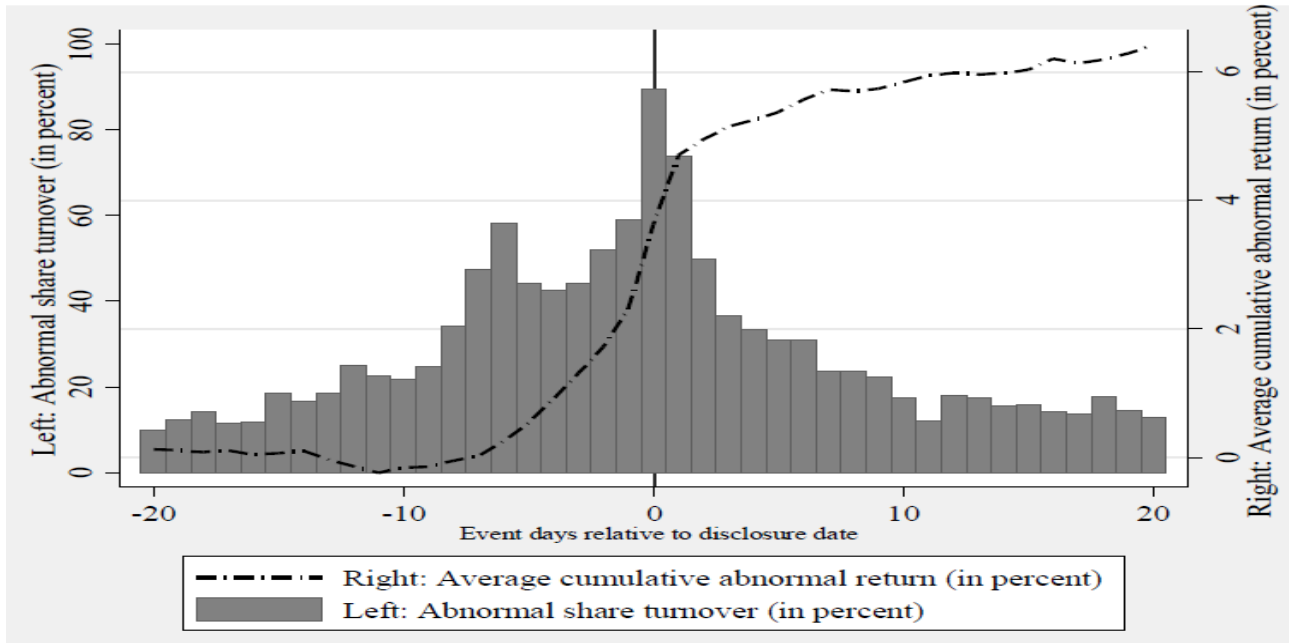


# Turnover rate for CEOs



What about the economic  
and stock market  
performance??

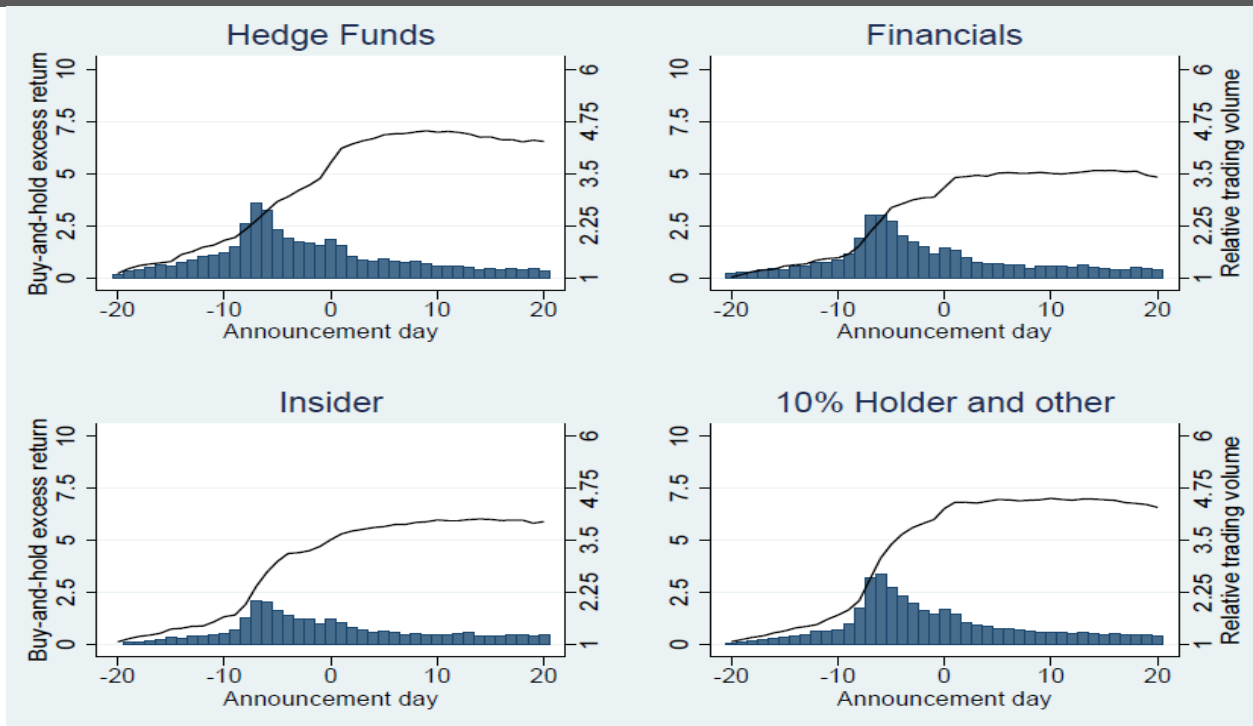
# Short-term return around announcement date



Source: Becht, M., J. Franks, J. Grant and H. Wagner, "The Returns to Hedge Fund Activism: An International Study," *European Corporate Governance Institute Working Paper Series in Finance*, No 402/2014.

# Short-term return??

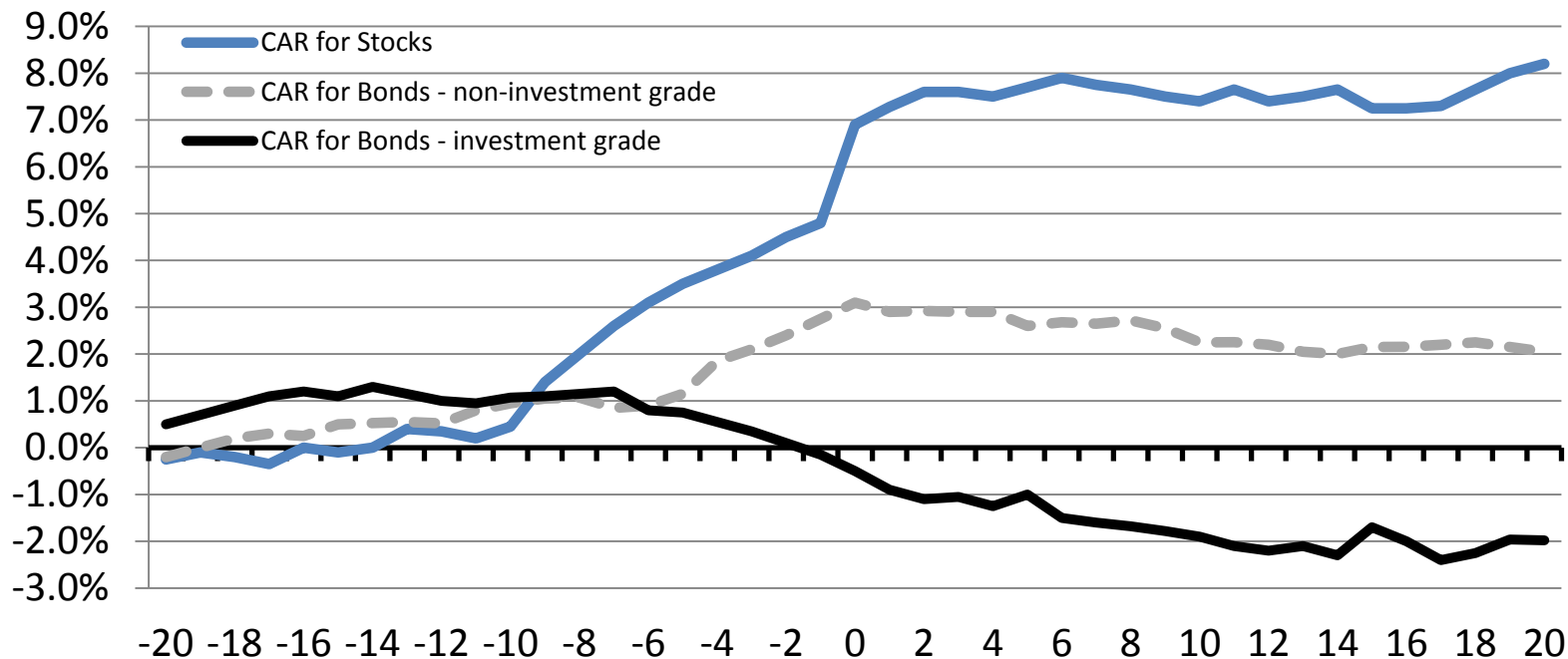
All 13D filings, whatever the source, are followed by  
“abnormal” returns



Source: von Lilienfeld-Toal, Ulf and Jan Schnitzler, “What is special about Hedge Fund Activism? Evidence from 13-D filings”  
*Working Paper available on SSRN, June 4, 2014.*



# Cumulative “abnormal” return (CAR) of stocks and bonds of companies targeted by hedge fund activism

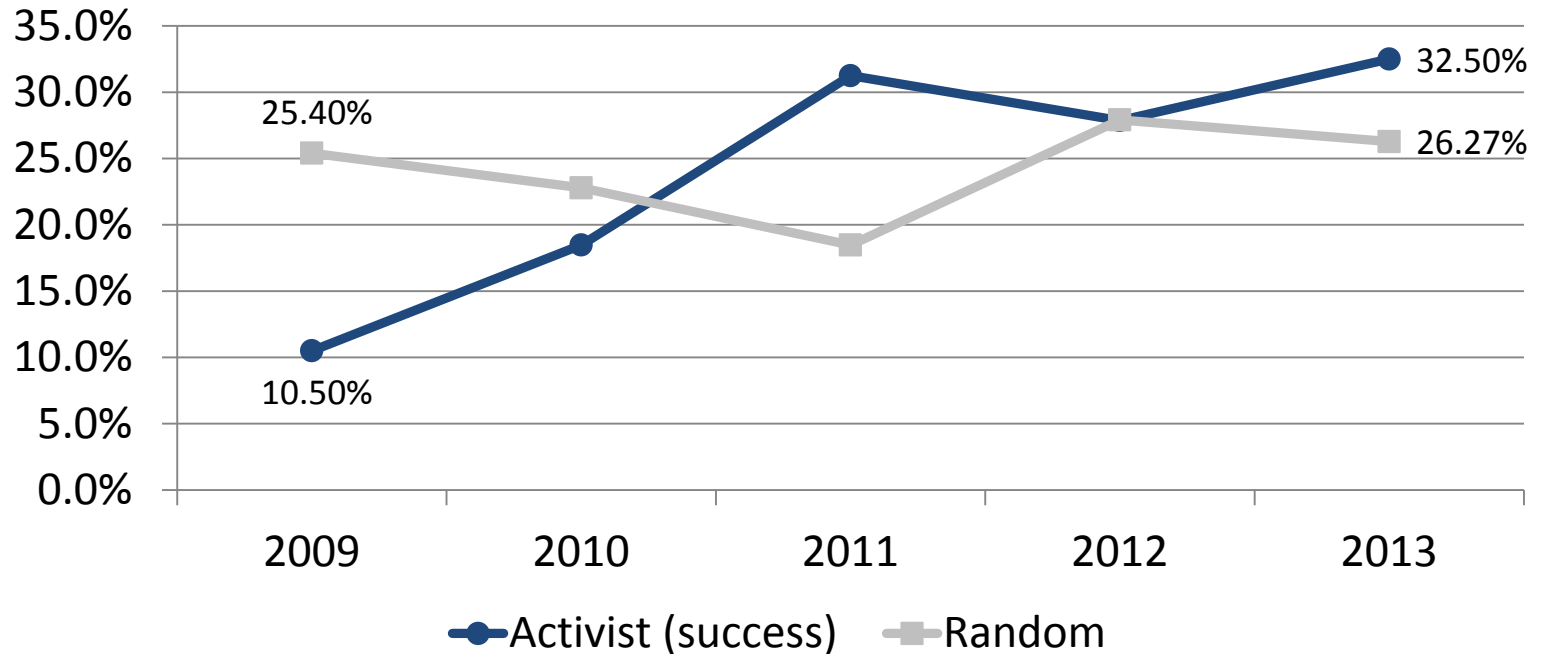


Source: adapted from Hadiye Aslan and Hilda Maraachlian, “Wealth effects of hedge fund activism,” Paper submitted to the European Finance Association, 36th annual conference, February 2009.



# D/E Ratio

## Median results





# Comparison of compounded annual total shareholder return (TSR)

(Dec 31, 2009 to Dec 31, 2013)

Centile	TSR Activist sample	TSR Random sample
25 <sup>th</sup>	-3.36%	0.66%
50 <sup>th</sup>	<b>14.64%</b>	<b>13.00%</b>
75 <sup>th</sup>	28.00%	25.30%
90 <sup>th</sup>	42.55%	50.59%
Mean	12.42%	13.92%

S&P 500	Dow Jones Industrial
13.47%	12.29%



# ...but the activists that were successful at getting the targeted firm sold off...

Centile	TSR
25 <sup>th</sup>	16.75%
50 <sup>th</sup>	<b>41.25%</b>
75 <sup>th</sup>	96.33%
90 <sup>th</sup>	169.27%
<b>Mean</b>	<b>94.29%</b>

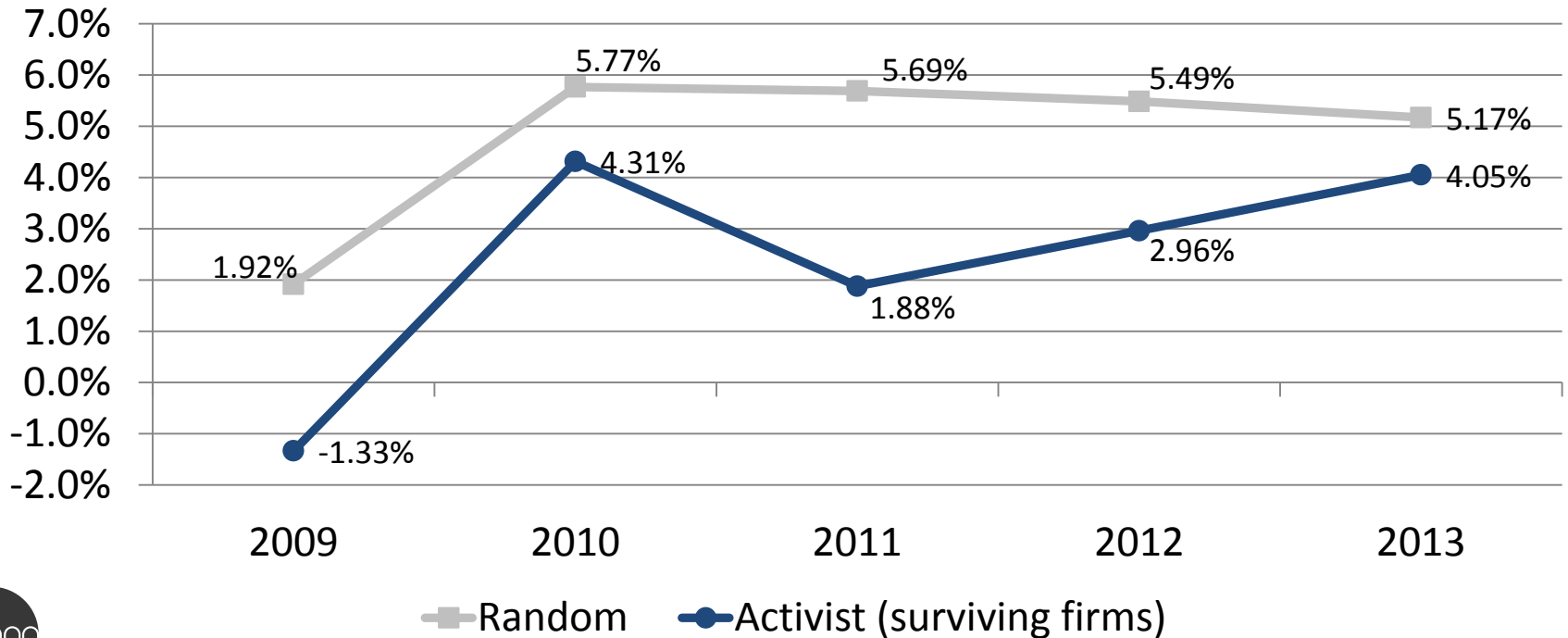


# Three measures often used in econometrics to assess the performance of activist interventions

- **ROA** = return on assets
- **Tobin's Q** = market value of the firm/  
book value of the firm
- **M/B** = market value of shareholder's equity/book  
value of shareholder's equity

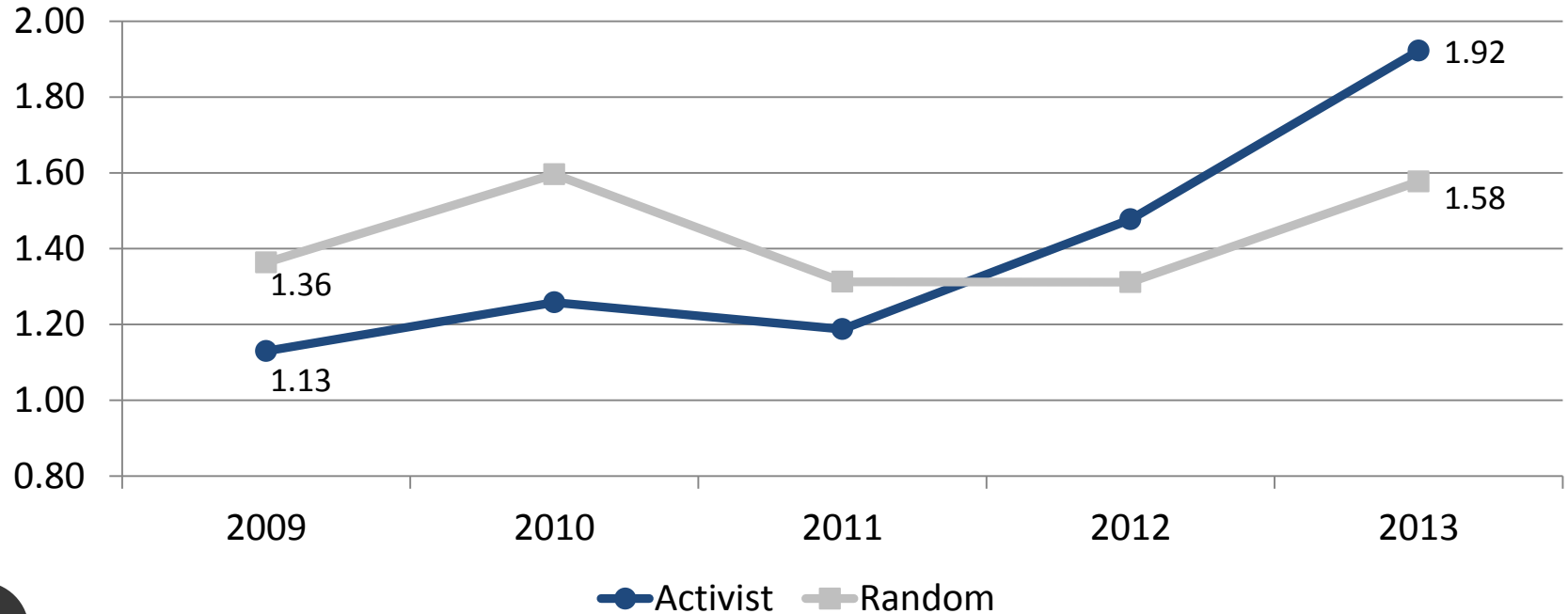
# ROA

## Median results



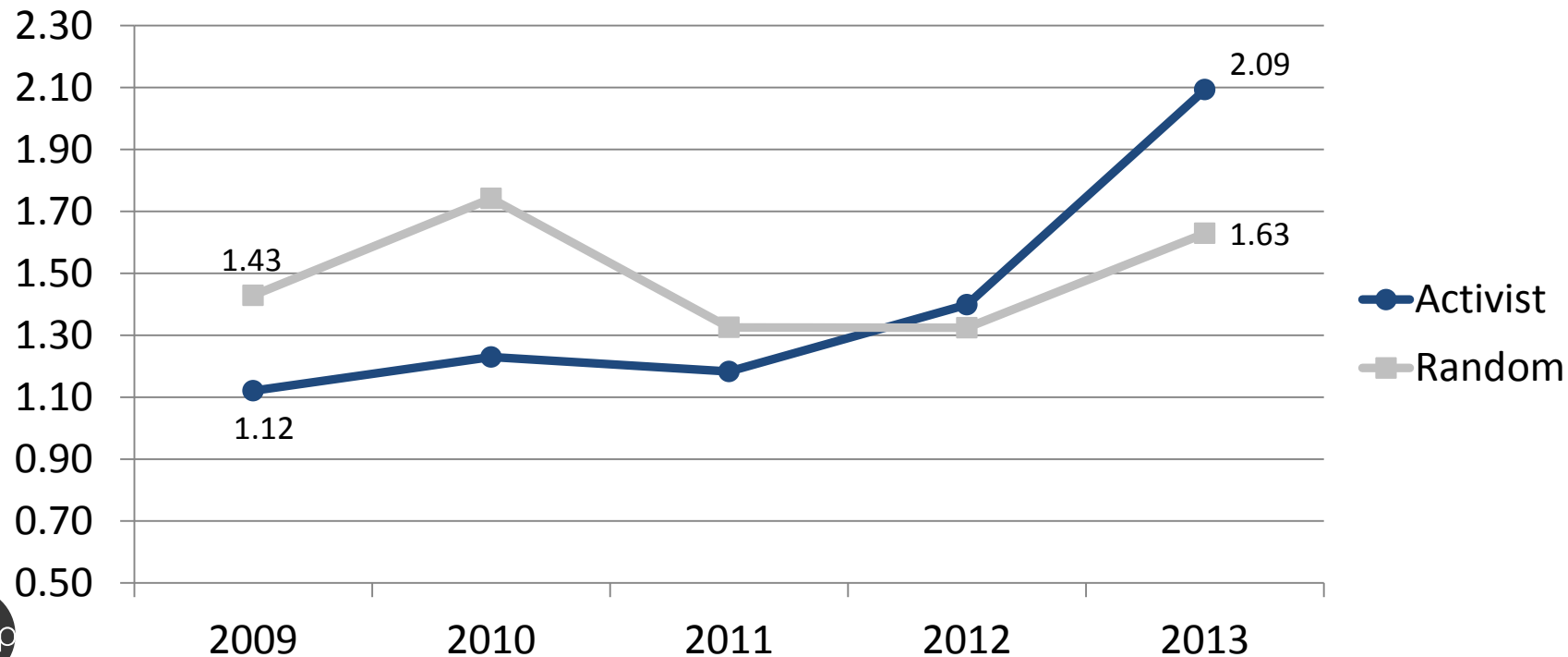
# Tobin's Q

## Median results

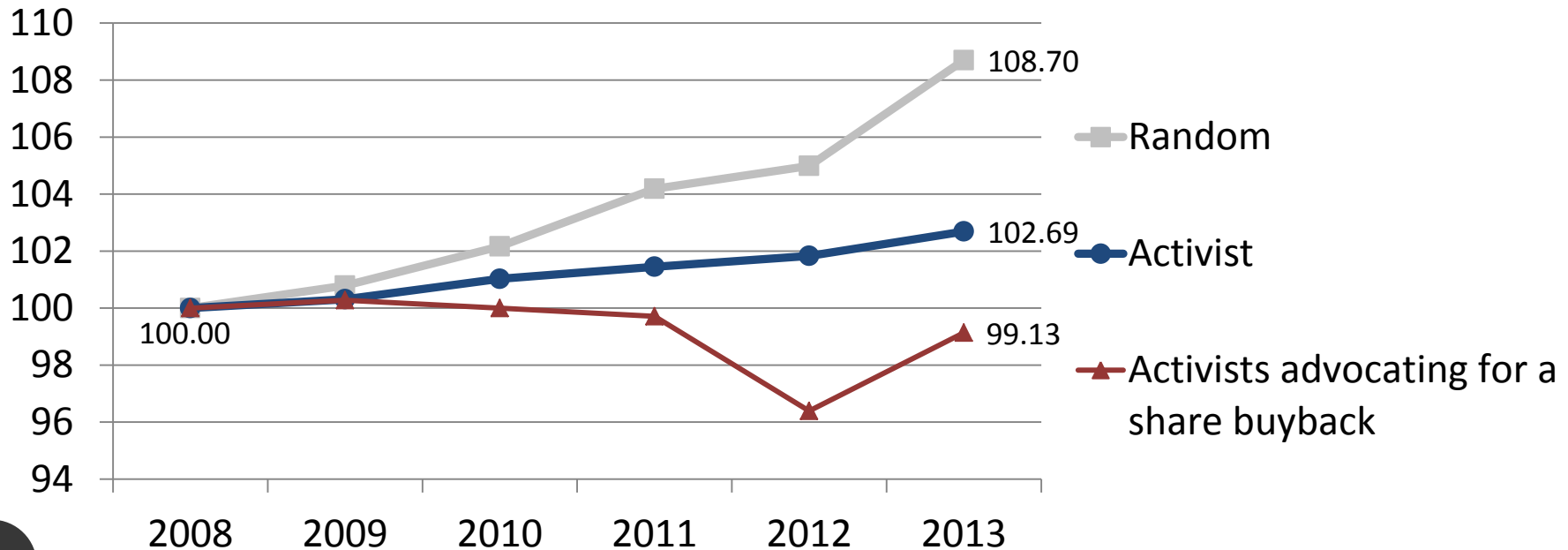


# M/B Ratio

## Median results



# Influence of share buyback on these ratios. Number of shares outstanding (2008 = 100) Median for surviving firms



# Arguments in favor of hedge fund activism

- Their interventions seek to add muscle and rigor to boards, to offset the perceived imperfections of « good » fiduciary governance as decreed since Sarbanes-Oxley. *Indeed, some boards have lost legitimacy and credibility as a result of their inability to rein in executive compensation and their limited knowledge of the company's workings.*
- They get management and boards to focus on the optimal use of cash and the best capital structure for the company's shareholders. *What's best in the short term may turn out to be dismal in difficult economic circumstances.*
- These “activists” cast a different, fresh look at the company's strategy and performance. *Doubtful as most of the time their demands amount to some form of financial engineering, in particular a fondness for selling the company and cashing in on the “control premium”.*





# Arguments against hedge fund activism

- Their interventions aim to create value mostly through financial engineering.  
*Indeed, mostly through the sale of the company*
- For the activist hedge funds, business firms are mere “properties”, with no other stakeholders than shareholders. *Of course!*
- Their interventions often takes the form of wealth transfer to shareholders from the company’s employees and debt holders rather than wealth creation. *Data seems to support this assertion*
- Some of their standard prescriptions often makes for hollowed-out companies with little resiliency during economic downturns and less apt to invest on the long-term.  
*Certainly possible*
- Their form of activism, as it is spreading to larger firms, could have negative effects on the economic and social fabric. *Possible if the phenomenon spreads even more.*
- Their interventions, when misguided and bound to fail, nevertheless inflict important collateral costs on targeted firms. *Many compelling examples of this phenomenon.*

# Preliminary conclusions

1. Hedge fund activists are not really that great at finance or strategy or operations, as some seem to believe (and as they relentlessly promote);
2. Their recipes are shop-worn and predictable, and (almost) never include any growth initiatives;
3. Their success mostly comes from the sale of the targeted firm (or from “spin-offs”); their performance otherwise barely matches the performance of the S&P 500 and that of a random sample of firms;
4. The strong support they receive from institutional investors is rather surprising and quite unfortunate;
5. The form of “good” governance imposed on companies since Sarbanes-Oxley as well as the “soft” activism of institutional funds have proved a boon for the activist funds.



# Coping with the « activism » phenomenon...

- Institutional funds need to review their policies of support to activist hedge funds;
- Institutional investors should ensure that their form of « soft » activism does not serve only to open the gate for « hard » activism by hedge funds;
- Boards must evolve toward a more *activist* governance to regain their legitimacy and credibility.



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