

February 22, 2013

Bite the Apple; Poison the Apple; Paralyze the Company; Wreck the Economy

The activist-hedge-fund attack on Apple—in which one of the most successful, long-term-visionary companies of all time is being told by a money manager that Apple is doing things all wrong and should focus on short-term return of cash—is a clarion call for effective action to deal with the misuse of shareholder power. Institutional investors on average own more than 70% of the shares of the major public companies. Their voting power is being harnessed by a gaggle of activist hedge funds who troll through SEC filings looking for opportunities to demand a change in a company's strategy or portfolio that will create a short-term profit without regard to the impact on the company's long-term prospects. These self-seeking activists are aided and abetted by Harvard Law School Professor Lucian Bebchuk who leads a cohort of academics who have embraced the concept of “shareholder democracy” and close their eyes to the real-world effect of shareholder power, harnessed to activists seeking a quick profit, on a targeted company and the company's employees and other stakeholders. They ignore the fact that it is the stakeholders and investors with a long-term perspective who are the true beneficiaries of most of the funds managed by institutional investors. Although essentially ignored by Professor Bebchuk, there is growing recognition of the fiduciary duties of institutional investors not to seek short-term profits at the expense of the pensioners and employees who are the beneficiaries of the pension and welfare plans and the owners of shares in the managed funds. In a series of brilliant speeches and articles, the problem of short-termism has been laid bare by Chancellor Leo E. Strine, Jr. of the Delaware Court of Chancery, e.g., [One Fundamental Corporate Governance Question We Face: Can Corporations Be Managed for the Long Term Unless Their Powerful Electorates Also Act and Think Long Term?](#), and is the subject of a continuing Aspen Institute program, [Overcoming Short-Termism](#).

In his drive to enhance the shift of power over the management of companies from directors to shareholders, Professor Bebchuk has announced that he is pursuing empirical studies to prove his thesis that shareholder demand for short-term performance enforced by activist hedge funds is good for the economy. We have been debating director-centric corporate governance versus shareholder-centric corporate governance for more than 25 years. Because they are inconvenient to his theories, Professor Bebchuk rejects the decades of my and my firm's experience in advising corporations and the other evidence of the detrimental effects of pressure for short-term performance. I believe that academics' self-selected stock market statistics are meaningless in evaluating the effects of short-termism. Our debates, which extend over all aspects of corporate governance, have of late focused on my effort to obtain early disclosure of block accumulations by activist hedge funds and my endorsement of an effort to require institutional shareholders to report their holdings two days, rather than 45 days, after each quarter. It is in the context of these efforts, opposed by the activists who benefit from lack of transparency, that Professor Bebchuk has announced his research project.

If Professor Bebchuk is truly interested in meaningful research to determine the impact of an activist attack (and the fear of an activist attack) on a company, he must first put forth a persuasive (or even just coherent) theory as to why the judgments as to corporate strategy

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and operations of short-term-focused professional money managers should take precedence over the judgments of directors and executives charged with maximizing the long-term success of business enterprises. There is nothing persuasive about his view, whether as theory or experience. Furthermore, he must take into account the following:

1. As to all companies that were members of the Fortune 500 during the period January 1, 2000 to December 31, 2012, what was the impact on the price of the shares of a company that missed the “street estimate” or “whisper number” for its earnings for a quarter and what adjustment did each of those companies make to its capital expenditures, investment in research and development and number of employees for the balance of the year of the miss and the following year.
2. 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.
3. Interviews with the CEO’s of the Fortune 500 as to whether they agree or disagree with the following statements:
  - a) From the Aspen paper, “We believe that short-term objectives have eroded faith in corporations continuing to be the foundation of the American free enterprise system, which has been, in turn, the foundation of our economy. Restoring that faith critically requires restoring a long-term focus for boards, managers, and most particularly, shareholders—if not voluntarily, then by appropriate regulation.”
  - b) From a 2002 interview with Daniel Vasella, CEO of Novartis in [Fortune Magazine](#), “The practice by which CEOs offer guidance about their expected quarterly earnings performance, analysts set ‘targets’ based on that guidance, and then companies try to meet those targets within the penny is an old one. But in recent years the practice has been so enshrined in the culture of Wall Street that the men and women running public companies often think of little else. They become preoccupied with short-term ‘success,’ a mindset that can hamper or even destroy long-term performance for shareholders. I call this the tyranny of quarterly earnings.”

Martin Lipton