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Do Activist Hedge Funds Really Create Long Term Value?

About a year ago, Professor Lucian Bebchuk took to the pages of the Wall Street Journal to declare that he had conducted a study that he claimed proved that activist hedge funds are good for companies and the economy. Not being statisticians or econometricians, we did not respond by trying to conduct a study proving the opposite. Instead, we pointed out some of the more obvious methodological flaws in Professor Bebchuk's study, as well as some observations from our years of real-world experience that lead us to believe that the short-term influence of activist hedge funds has been, and continues to be, profoundly destructive to the long-term health of companies and the American economy.

Recently, the Institute for Governance of Private and Public Organizations issued a paper that more systematically examines the flaws of Professor Bebchuk's econometric and statistical models, concluding that "the Bebchuk *et al.* paper illustrates the limits of the econometric tool kit, its weak ability to cope with complex phenomena; and when it does try to cope, it sinks quickly into opaque computations, remote from the observations on which these computations are supposedly based." The paper also observes that "activist hedge funds operate in a world without any other stakeholder than shareholders. That is indeed a myopic concept of the corporation bound to create social and economic problems, were that to become the norm for publicly listed corporations."

Further the Institute's paper concludes: "[T]he most generous conclusion one may reach from these empirical studies has to be that "activist" hedge funds create some short-term wealth for some shareholders (and immense riches for themselves) as a result of investors, who believe hedge fund propaganda (and some academic studies), jumping in the stock of targeted companies. In a minority of cases, activist hedge funds may bring some lasting value for shareholders but ***largely at the expense of workers and bond holders***; thus, the impact of activist hedge funds seems to take the form of wealth transfer rather than wealth creation."

The Institute's paper is well worth reading for its academically rigorous, as well as common sense, refutation of Bebchuk's claims.

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