Activist Interventions and Long-Term Value

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Present findings of:

- Lucian Bebchuk, Alon Brav, and Wei Jiang, “The Long-Term Effects of Hedge Fund Activism,” forthcoming, 114 *Columbia Law Review* _ (June 2015).

The “Myopic Activists” Claim:

- Activist interventions by investors that do not have long investment horizons tend to produce “myopic” corporate changes, which come at the expense of long-term performance and value =>
- Therefore, activist interventions are in the long term detrimental to companies and their long-term shareholders.

The "Myopic Activists" Claim (2)

- Activist investors "lobby for significant … changes, hoping to drive up the share price and book quick profits. Then they bail out, leaving corporate management to clean up the mess."
(William George, former Medtronic CEO, Dealbook Op-ed)

The “Myopic Activists” Claim (3)

- Activists investors “are preying on American corporations to create short-term increases in the market price of their stock at the expense of long-term value.” (Wachtell Lipton, memo on activism)

“Myopic Activists” Claim Frequently Invoked

- To support arrangements that decrease power/influence of activist investors, e.g.
  - Tightening of 13D rules
  - 10% poison pills
  - Staggered boards
  - Limits on the rights of short-term shareholders
- To advise boards to “circle the wagons” and take an adversarial approach towards activists.

Need for Testing

- The short-termism claim does not follow from assuming that markets are inefficient and activists have short horizons. (Bebchuk, The Myth that Insulating Boards Serves Long-Term Value, *Columbia Law Review*, Oct 2013).
- The claim is a testable empirical proposition for which supporters have not provided empirical support.

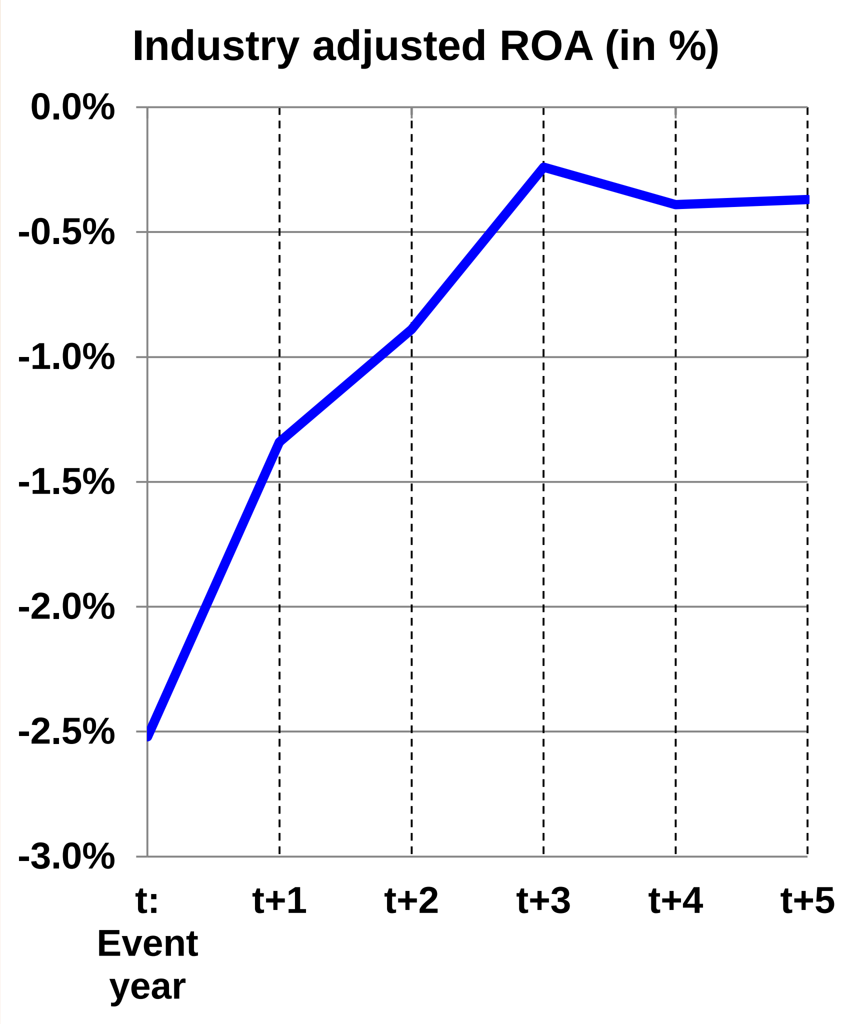
Need for Testing (2)

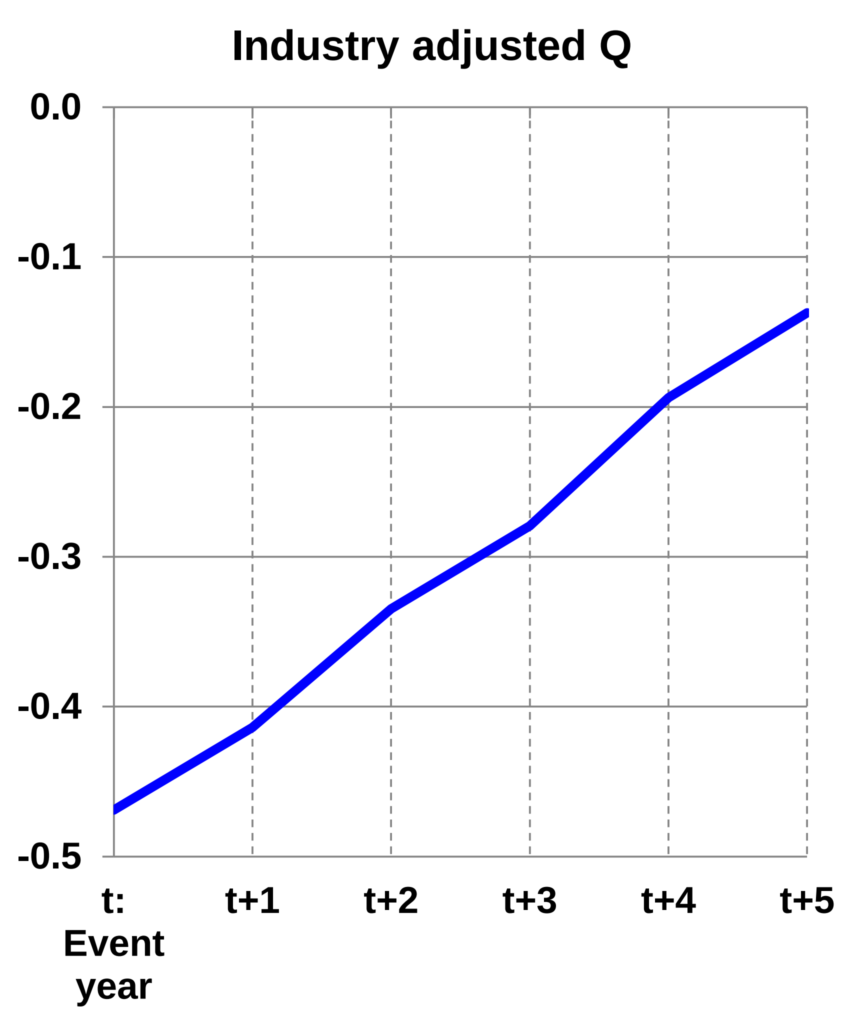
- In March 2013, Martin Lipton challenged me to study the following “important question:” “[f]or companies that are the subject of hedge fund activism and remain independent, what is the impact on their operational performance and stock price performance relative to the benchmark… after a 24-month period”

  (Wachtell Lipton, *Bite the Apple* memo)

- We undertake a direct empirical test of this question based on the universe of about 2,000 activist interventions taking place during 1994-2007.

The Evolution of ROA and Q Over Time (1)

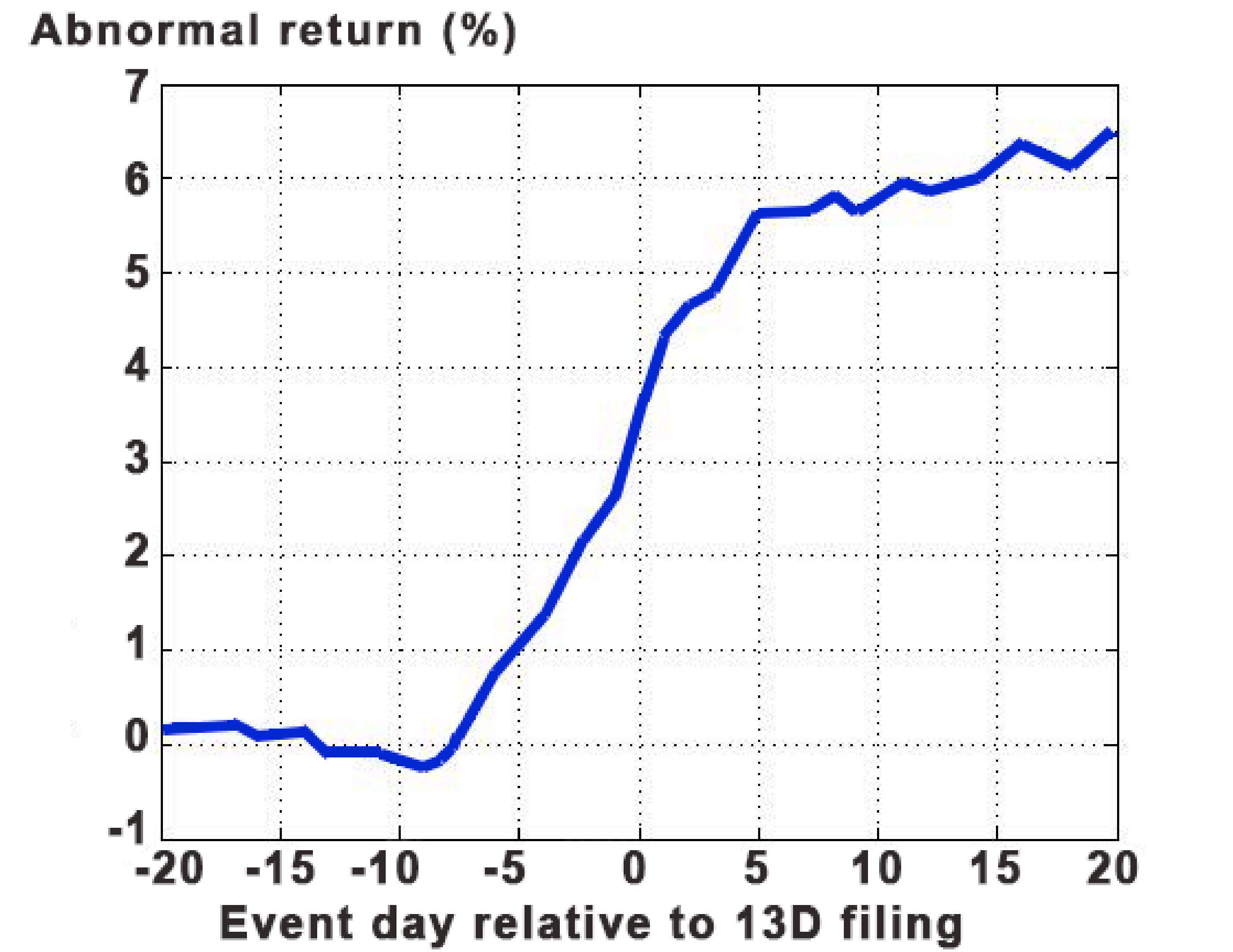




The Evolution of ROA and Q over Time (2)

- A regression analysis, controlling for industry, firm size, and year, shows that:
  - Three, four, and five year after the activist intervention, the levels of both Q and ROA are higher than at the time of the intervention; and
  - The difference is statistically significant and economically meaningful.

Short-Term Stock Returns around 13D Filings



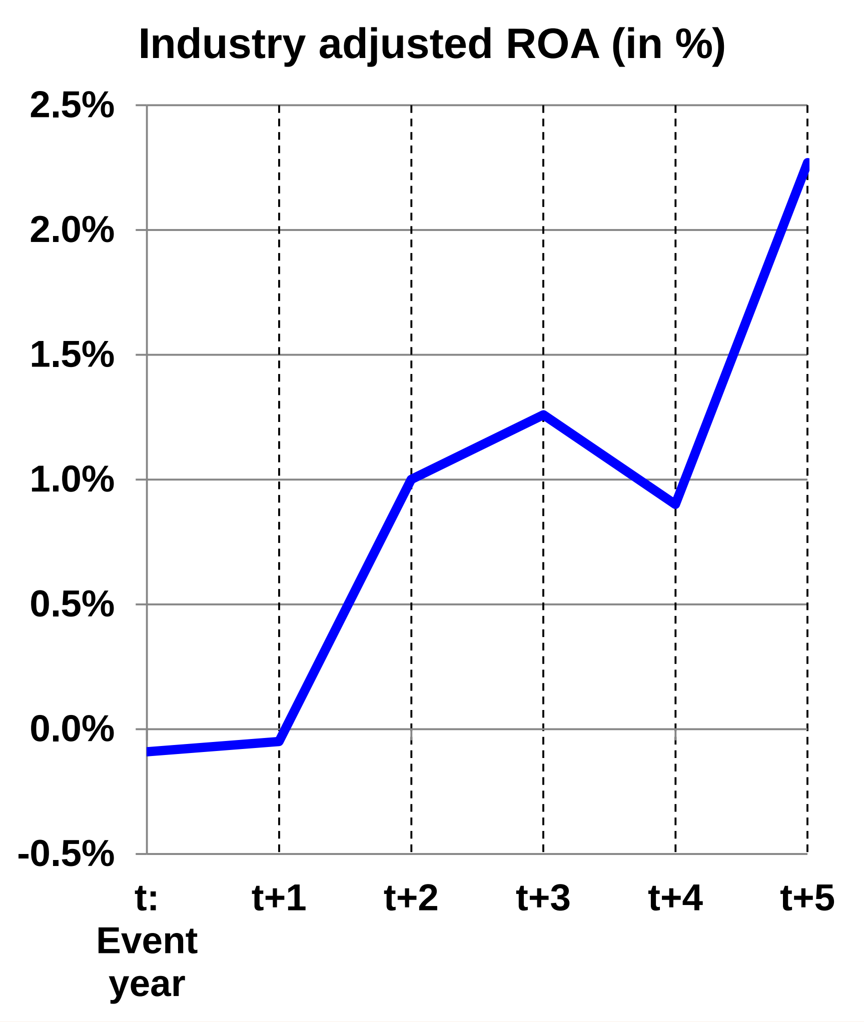
Buy-and-Hold Abnormal Returns Subsequent to Hedge Fund Intervention

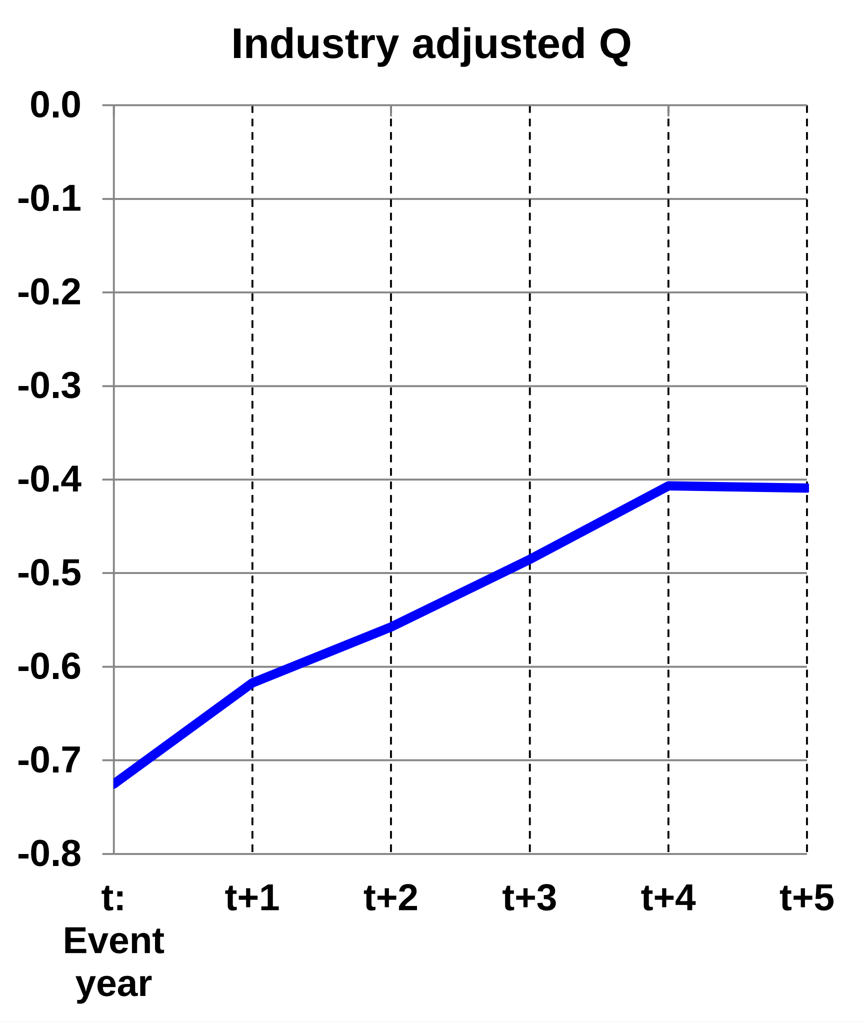
Window	Average abnormal return	
	Equal-weight	Value-weight
[+1,+36]	7.17	2.58
[+1,+60]	-0.29	5.81

Buy-and-Hold Abnormal Return Subsequent to Hedge Fund Exit

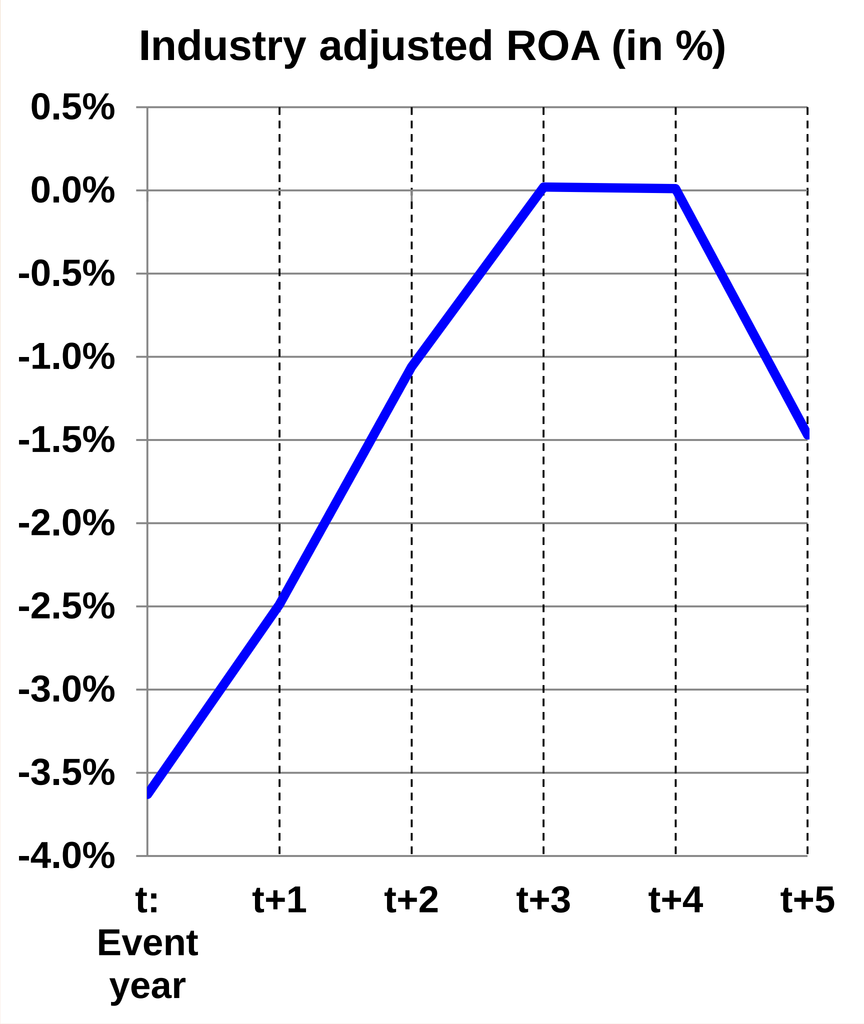
Window	Average abnormal return	
	Equal-weight	Value-weight
[1,+36]	19.06	14.9

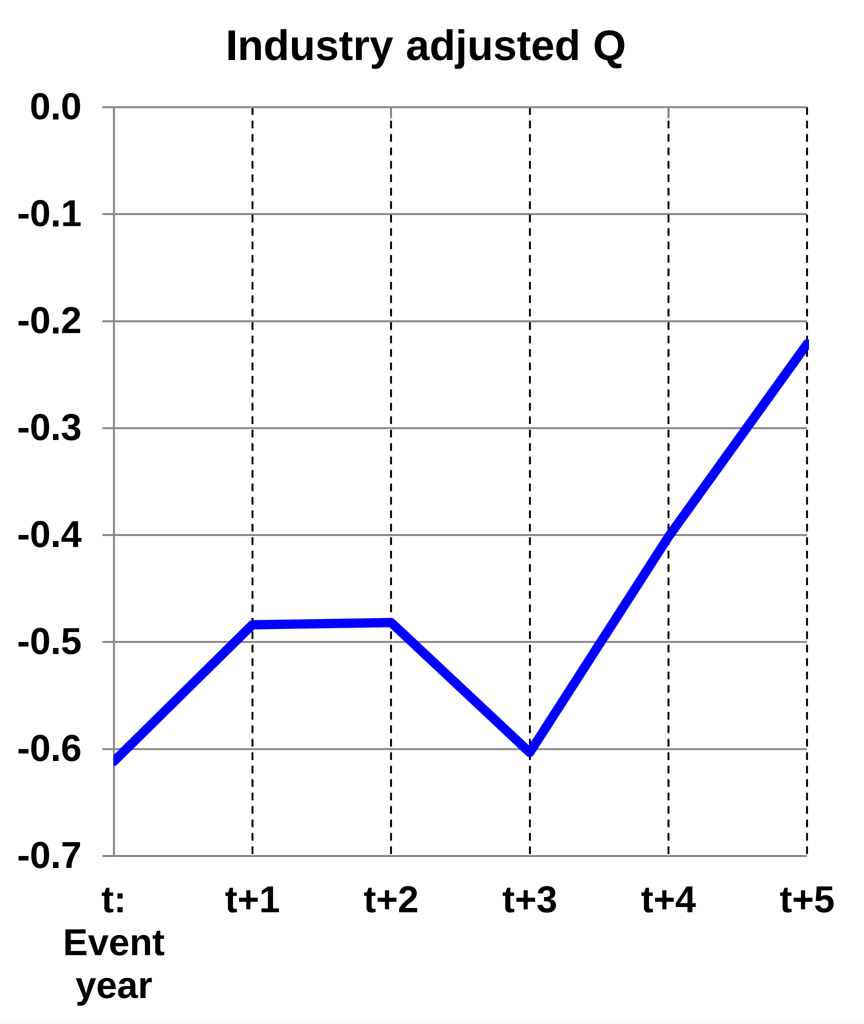
Evolution of ROA and Q for the "Adversarial Interventions" Subsample





Evolution of ROA and Q for the “Investment-Limiting Interventions” Subsample





Performance during the Crisis

- Did activist interventions during 2004-2007 make companies more vulnerable to the subsequent financial crisis?
- A regression analysis of the changes in operating performance during the crisis period indicates that such targets were not more adversely affected by the crisis than companies without activist interventions.

The Wachtell Lipton Criticism

- Wachtell Lipton issued three detailed memoranda criticizing the study:
  - Current Thoughts About Activism;
  - The Bebchuk Syllogism; and
  - Empiricism and Experience; Activism and Short-Termism; the Real World of Business.
- Examination of all the claims made in these memos indicates that none of them provides a good basis for Wachtell's opposition to relying on the findings of our study.

Wachtell Claim 1

- Claim: Q and ROA are imperfect measures of operating performance.

But:

- Q and ROA are standard measures used by financial economists.
- Wachtell does not advocate an alternative measure, but just seeks to avoid reliance on empirical work.

Wachtell Claim 2

- Claim: Given the inherent imperfections of empirical analysis, it is better to rely on “the depth of real-world experience” of business leaders and their advisors.

But:

- Given the existence of objective data about stock returns and operating performance, empirical evidence provides a superior tool over impressionistic reports from involved individuals.

Wachtell Claim 3

- Claim: Activists do not produce improvements but are simply good stock pickers.

<u>But</u>:

- Our study provides reasons for believing that the identified improvements are at least partly due to the activist interventions.
- In any event, the “stock pickers” claim represents a shift to a new position and abandoning the myopic activists claim that activists decrease long-term value.

Wachtell Claim 4

- Claim: Other empirical studies reach different conclusions (citing a laundry list of 27 studies).

But:

Reviewing each of the studies cited by Wachtell (review available on the Harvard corporate governance online forum), we found that not a single one of them contradicted our findings.

Wachtell Claim 5

- Claim: Regardless of whether activist interventions do not hurt the target company, they might have adverse effects on companies not targeted.

But:

- Corporate directors should focus on the interests of their shareholders =>
- The asserted negative externalities cannot provide a basis for directors' following the adversarial approach towards activists that Wachtell recommends.

Conclusion

- The myopic activists claim is not supported by the data.
- Going forward, policymakers, institutional investors and boards should:
  - Reject arguments based on the claim that activist interventions tend to be detrimental to long-term value; and
  - Reject calls for legal and corporate arrangements that impede and discourage shareholder interventions.