SHAREHOLDER ACTIVISM
RESEARCH SPOTLIGHT
Activist shareholders purchase shares in a public company with the express purpose of effecting direct change on governance or strategy.

- **Proponents:**
  
  (+) Companies with active shareholders have better long-term success.
  (+) Activists serve as a necessary element in the “market for corporate control.”
  (+) Put a spotlight on managerial and boardroom complacency.

- **Opponents:**
  
  (-) Disruptive outsiders interested in short-term or private gains.
  (-) Bring a short-term perspective that undermines long-term success.

Most research finds that activists are successful in influencing companies. Their impact on shareholder value is uncertain.
UNION / PENSION ACTIVISM

• Agrawal (2012) examines the AFL-CIO voting record in director elections.
• Finds that the AFL-CIO is:
  – More likely (11%) to vote against directors of unionized than nonunionized firms.
  – More likely (14%) to vote against directors when company is in a labor dispute.
• Also finds union opposition is associated with lower shareholder returns.
• Conclusion: union funds promote private interests.

“Union pension funds have preferences that partly reflect union worker interests, rather than equity value maximization…. Their opposition also appears to benefit union workers at the expense of shareholder value.”
• Del Guercio and Woidtke (2014) also study union activism.

• Sample: 610 nonbinding proposals to adopt majority voting, 1996-2004.
  – Compare outcomes of union-sponsored vs. non-union sponsored proposals.

• Find:
  – Companies that adopt union-sponsored proposals have improved labor relations.
  – Stock market reaction is negative if unions are sponsor, positive if non-unions.
  – Directors who adopt union-sponsored proposals lose significantly more external board seats than non-union sponsored proposals.

• Conclusion: union activism benefits union but not shareholders.

“We find consistent evidence from both the labor market for directors and the stock market suggesting that unionized employees gain from improved union relations at the expense of shareholders.”
Matsusaka, Ozbas, and Yi (2017) also study union activism.

- Examine all proposal types: board, compensation, antitakeover, etc.

Find that:
- Unions increase the frequency of proposals in contract expiration years.
- Wage increases are higher when unions sponsor and then withdraw proposal (i.e., use as bargaining chip).
- No evidence that companies adopt “good governance” following union proposals; positive evidence when other shareholders are sponsor.

Conclusion: union activism benefits union but not shareholders.

“A union is unlikely to admit that its proposal is being advanced for opportunistic reasons.”
• Barber (2007) examines the impact of CalPERS pension fund activism on shareholder outcomes.

  – CalPERS “Focus list”: companies targeted for especially poor governance.

• Finds:
  – Focus firms have significantly negative performance prior to CalPERS activism.
  – Marginal positive returns when CalPERS adds a firm to its focus list.
  – Long-term returns are statistically insignificant.

• Conclusion: impact of pension activism is inconclusive.

“Long-run returns are simply too volatile to conclude that the long-run performance of focus-list firms is unusual.”

Sample: 34 socially responsible mutual funds, 3+ year returns through 2001.

Find that socially responsible mutual funds significantly underperform comparable indices (0.30% per month).

Note that model does not take into account “the non-financial utility of ‘doing good.’”

Conclusion: socially responsible investments underperform the market.

“Our results put a lower bound on the value of the non-financial utility that one should derive from socially responsible investing.”
Renneboog, Ter Horst, and Zhang (2008) also study the financial performance of socially responsible investing.


Find that SRI mutual funds:
- Underperform their benchmarks by 2.2% to 6.6% per year.
- But not significantly different from comparable funds on risk-adjusted basis.

Conclusion: socially responsible investments might not underperform.

“SRI investors who derive non-financial utility from investing in companies meeting high ethical/social standards may be content with a lower rate of return.”
Rees and Rodionova (2016) examine the impact of socially responsible activism on corporate practices.

- 160 firms targeted on climate change; 310 firms not targeted (control group).

Find that:
- Targeted companies are significantly more likely to adopt activist policies.
- Adoption is negatively associated with concentration of share ownership and negatively associated with shareholder-centric governance policies.

Conclusion: companies adopt policies in response to shareholder activism.

“Our results demonstrate that engagement by a responsible investment index... significantly increased the probability that a company would adopt a set of policies, management systems, and reporting practices aiming to mitigate the impact of climate change.”
Brav, Jiang, Partnoy, and Thomas (2008) provide a detailed analysis of hedge fund activism.

Sample: 236 hedge funds, 882 target companies, 2001-2006.

Find that:

– Initial ownership stake is 6.3%; 14% if multiple hedge funds file as one group.
– Positive abnormal returns on announcement day of 2.0%; 20-day 7.2%.
– Targeted firms increase payouts, operating performance (ROA), and CEO turnover.

Conclusion: hedge fund activists positively impact outcomes and stock prices.

“Hedge fund activism can be viewed as a new middle ground between internal monitoring by large shareholders and external monitoring by corporate raiders… The presence of these hedge funds and their potential for intervention exert a disciplinary pressure on the management of public firms to make shareholder value a priority.”
Klein and Zur (2009) also study the impact of hedge fund activism.


Find that:

- Activist hedge funds achieve their stated objective 60% of the time.
- Target firms exhibit abnormal returns of 10.2% over 60 days; 11.4% over year.
- However, targets exhibit a long-term decrease in performance (ROA) and cash from operations.

Conclusion: impact of hedge fund activism is mixed.

“Activists are extremely successful in getting existing management to acquiesce to their demands.”

Sample: 114 target companies, 2002-2006.
- Compares the return of a portfolio of these companies with the market.
- Measures performance from filing date to date of sale, merger, or end of 2006.

Finds that the hedge fund portfolio outperforms market by 12%. However, the results are highly sensitive to risk adjustments.

Conclusion: activist hedge funds have higher returns, higher risk.

“This portfolio is made up of big winners and big losers…. The sets of returns for the hedge fund portfolios have higher standard deviations than the market returns, signaling greater volatility of returns and a higher required rate of return.”
• Bebchuk, Brav, and Jiang (2015) also study the financial performance of activist hedge fund.


• Find target companies:
  – Exhibit positive abnormal returns (5%) over the 40-day announcement period.
  – Outperform the market over a 3- and 5-year basis.
  – Outperform peers (ROA) over a 3- and 5-year basis.

• Conclusion: activist interventions improve corporate outcomes.

“Policymakers and institutional investors should not accept the validity of the frequent assertions that activist interventions are costly to the firms and their shareholders in the long term.”
HEDGE FUND ACTIVISM

• deHaan, Larcker, and McClure (2017) also study hedge fund performance.

• Sample: 1,964 activist interventions, 1994-2011.

• Find:
  – Positive abnormal returns in the 21-day announcement period (5%).
  – No long-term positive returns on a value-weighted or aggregate basis (2-years).
  – Equal-weighted returns driven by firms with very small market values; acquisitions.
  – No long-term improvement in operating performance (ROA).

• Conclusion: activism in aggregate does not lead to improvement in outcomes.

“Our results suggest that hedge fund activists have a largely neutral impact on firm performance and aggregate shareholder wealth.”

gsb.stanford.edu/cgri-research
Coffee and Palia (2014) conduct a review of the research literature on hedge fund activism.

Sample: unspecified number of empirical studies.

Find that:
- Activists target companies with lower market valuations (Tobin’s Q).
- Target firms earn positive abnormal average returns around the announcement.
- Activists have mixed impact on long-term performance (stock price and ROA).

Conclusion: activist hedge funds have uncertain impact on firm performance.

“We find the evidence decidedly mixed on most questions (other than the short-term stock price impact). In particular, we find the conclusions about improvements in target operating performance that have been expressed by some to be overextended beyond their actual data.”
• Gow, Shin, and Srinivasan (2016) study the impact of hedge fund activism on board turnover.

• Sample: 1,490 activist interventions, 2004-2012.

• Find that:
  — Companies targeted by activists have higher 1-year director turnover than companies not targeted by activists (18% vs. 12.5%).
  — Turnover is higher even if activists do not make board-related demands.
  — Activism increases the sensitivity of director turnover to performance.

• Conclusion: activism improves director accountability.

“Our results suggest that activists need not even engage in, let alone win, proxy contests to remove directors. … Our results are consistent with shareholder activism increasing board turnover and accountability for poor performance.”
• Borek, Friesner, and McGurn (2017) evaluate the impact of shareholder activism on board composition.


• Find that activist campaigns leads to new directors who are:
  – Younger; less ethnic diversity; lower female representation.
  – More independent.
  – Investment professionals; more financial expertise.

• Conclusion: activism leads to changes in board composition.

“Public shareholder activism generally leads to younger, more independent, but less diverse board candidates…. Typically activists favor nominees with financial experience and incumbent boards favor nominees with executive experience.”
Gatchev (2013) calculates the full cost of a proxy contest.

- Measures the net return of proxy contests taking into account full cost, including demand negotiations, board representation, and the contest.

Finds that:
- Average proxy contest costs $10.7 million.
- Monitoring costs reduce activist returns by two-thirds.
- Mean net activist return is close to zero; only top quartile earn high returns.

Conclusion: proxy contests are more costly than many realize.

“The evidence in this paper provides support for the recently failed efforts by the U.S. Securities and Exchange Commission to reduce the costs of using the proxy process [proxy access].”
CONCLUSION

• Shareholder activists seek to impose direct change on a company’s leadership, strategy, or governance.

• Research generally finds that union activism tends to promote the private interests of the union and is not broadly beneficial to investors.

• Socially responsible investors are moderately successful in changing corporate practices. There is little evidence this improves shareholder value.

• Activist hedge funds are highly successful in achieving objectives. Disclosure of investment is associated with positive short-term abnormal returns.

• The long-term impact of activist hedge funds is uncertain. Any gains, if lasting, are concentrated in a subset of firms and largely driven by takeover activity.


