Paper Presentation
Hedge Fund Activism, Corporate Governance and Firm Performance
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Hedge Fund Activism:
• Acquiring a significant amount of shares of a company with the objective to influence the management of the company

Some important questions:
• Beneficial or harmful for shareholders?
• Who are the targets and what is their response?
• What is the effect on firm performance?

Previous literature
• Bethel, Liebeskind and Opler (1998): look on activist blockholders in the 1980s and compare activists, financial organizations and strategic investors
→ Targeted poorly performing firms, positive effect on profitability and shareholder value
Data

No general definition for hedge funds, here:
• Pooled, privately organized investment vehicles, administered by professional investment managers, not widely available to the public and they operate outside of regulation and registration requirements

Problem: No database for activist hedge funds
• Construction of own sample based on schedule 13D filings
  → Investors must file within 10 days after acquiring more than 5% of a class of securities

Manual examination of all 13D filing from 2001 to 2006
• Distinguishing hedge funds from private equity funds and venture capital funds
• 236 hedge funds with 1032 events
• 27 additional events from manual search on 13F filings
• All in all 236 activist hedge funds, 1059 hedge fund-target pairs, 882 unique targets
Hedge Funds’ Objectives and Investment

Basically 5 types of objectives:
- Maximization of shareholder value due to undervaluation
- Capital structure, e.g. dividends, restructuring
- Governance, e.g. compensation, CEO
→ Success or partial success: 66%

Categorization whether non-hostile or hostile:
- Communication with the board/management
- Public criticism → proxy fight
→ 295 hostile events, 27.9% of the sample
→ Response of firms: 30% accept, 30% negotiate, 40% fight/resist

Investment horizon median:
Non-hostile: 369 days
Hostile: 319 days

<table>
<thead>
<tr>
<th>Percentile</th>
<th>All Events</th>
<th>Hostile Events</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Invested Capital ($ Million)</td>
<td>% Ownership</td>
</tr>
<tr>
<td></td>
<td>Initial</td>
<td>Max.</td>
</tr>
<tr>
<td>5%</td>
<td>0.69</td>
<td>1</td>
</tr>
<tr>
<td>25%</td>
<td>3.5</td>
<td>4.6</td>
</tr>
<tr>
<td>50%</td>
<td>11.9</td>
<td>15.8</td>
</tr>
<tr>
<td>75%</td>
<td>40.3</td>
<td>54.6</td>
</tr>
<tr>
<td>95%</td>
<td>186.8</td>
<td>272.5</td>
</tr>
</tbody>
</table>

Hedge Fund Activism
Characteristics of Targets

First approach: matching

- Firms matched from same year, same industry and same 10 × 10 or 5x5 size and book-to-market sorted portfolios

Second approach: probit regression – yields similar results

→ Hedge funds seem to focus on generalizable problems in well understood firms, where markets can anticipate effect of activism
Stock Returns and Hedge Fund Activism

Event Day Returns:
abnormal buy-and-hold excess return on value weighted NYSE/AMEX/NASDAQ Index from CRSP

- (-20, 20) window
- Event date: schedule 13D filing
- 62% of events have positive abnormal return
- 2% jump on filing day, overall 7%
- Dropped from 15.9% in 2001 to 3.4% in 2006

Also look at abnormal share turnover:
- Spike before event

Cross sectional effect:
hostile events’ abnormal return 3.8% higher, sale stated as goal: 8.54% higher
Stock Returns and Hedge Fund Activism

Alternative Hypothesis tested and ruled out:
- Market overreaction and temporary price impact, buying pressure from filing
- Stock picking vs. value improvement: reaction to identification of undervalued firm
- Value expropriation from other stakeholders (e.g. executives), wealth redistribution

→ Positive effect around filing reflects positive effect of activism on firm value

Returns to Hedge Funds’ Investment/Long-Run Returns

<table>
<thead>
<tr>
<th>Deal Period</th>
<th>Raw Return</th>
<th>Annualized Market Adjusted</th>
</tr>
</thead>
<tbody>
<tr>
<td>1%</td>
<td>−0.938</td>
<td>−1.017</td>
</tr>
<tr>
<td>5%</td>
<td>−0.609</td>
<td>−0.708</td>
</tr>
<tr>
<td>25%</td>
<td>−0.068</td>
<td>−0.197</td>
</tr>
<tr>
<td>50%</td>
<td>0.181</td>
<td>0.042</td>
</tr>
<tr>
<td>75%</td>
<td>0.602</td>
<td>0.283</td>
</tr>
<tr>
<td>95%</td>
<td>2.372</td>
<td>1.532</td>
</tr>
<tr>
<td>99%</td>
<td>4.674</td>
<td>4.393</td>
</tr>
<tr>
<td>Mean</td>
<td>0.420**</td>
<td>0.206**</td>
</tr>
<tr>
<td>Std. Dev.</td>
<td>0.979</td>
<td>1.004</td>
</tr>
<tr>
<td>P-val (Mean = 0)</td>
<td>0.00%</td>
<td>0.00%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Window (Months)</th>
<th>Alpha Estimate</th>
<th>t-statistic</th>
<th>Alpha Estimate</th>
<th>t-statistic</th>
</tr>
</thead>
<tbody>
<tr>
<td>(−12,−10)</td>
<td>−1.023</td>
<td>−1.82</td>
<td>−2.377**</td>
<td>−3.18</td>
</tr>
<tr>
<td>(−9,−7)</td>
<td>0.283</td>
<td>0.54</td>
<td>−0.261</td>
<td>−0.42</td>
</tr>
<tr>
<td>(−6,−4)</td>
<td>−0.513</td>
<td>−1.02</td>
<td>−2.122**</td>
<td>−3.34</td>
</tr>
<tr>
<td>(−3,−1)</td>
<td>−0.664</td>
<td>−1.3</td>
<td>−1.663**</td>
<td>−2.33</td>
</tr>
<tr>
<td>Event</td>
<td>5.095**</td>
<td>6.72</td>
<td>1.616</td>
<td>1.18</td>
</tr>
<tr>
<td>(1,3)</td>
<td>1.093**</td>
<td>2.01</td>
<td>0.141</td>
<td>0.28</td>
</tr>
<tr>
<td>(4,6)</td>
<td>0.237</td>
<td>0.52</td>
<td>−0.683</td>
<td>−1.24</td>
</tr>
<tr>
<td>(7,9)</td>
<td>−0.093</td>
<td>−0.19</td>
<td>−0.005</td>
<td>−0.01</td>
</tr>
<tr>
<td>(10,12)</td>
<td>1.124</td>
<td>1.84</td>
<td>−0.041</td>
<td>−0.08</td>
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</tbody>
</table>

→ Returns of investments not much higher than of market, but in majority positive
Firm Performance

Comparison of firm performance from 2 years before to 2 years after event

• ROA as performance indicator
• Matching used for assessment:
  – year-by-year, on industry/size/book-to-market
  – beginning-of-period performance and industry matching

→ In general improvement in operating performance, but it takes time
Conclusion

• Paper performs a well founded and thorough examination of hedge fund activism with a unique and carefully constructed dataset → Time period 2001 – 2006, but afterwards?

• Positive market reaction to activism announcement and improvement in post-intervention performance → Better examination of long-term effects possible

• Level of hostility much smaller than often claimed

• In average not extreme short term orientation as often claimed

• Hedge Fund Activism: Midpoint between internal monitoring by large shareholders and external monitoring by corporate raiders → disciplinary pressure in management, reduction of agency costs