

# DOES HEDGE FUND «ACTIVISM» CREATE LONG TERM SHAREHOLDER VALUE?

PRESENTATION AT THE ANNUAL MEETING OF  
THE CENTER FOR CORPORATE GOVERNANCE  
CONFERENCE BOARD OF NEW YORK

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.....AND IS THAT THE RIGHT  
QUESTION?  
SHOULD WE ASK WHETHER  
THESE PLAYERS ARE MAKING  
CORPORATIONS BETTER FOR  
ALL STAKEHOLDERS?

# WHAT'S LONG TERM? WHAT'S SHORT-TERM?

- Not a set, fixed, time frame: three years may be long-term in some industries and very short-term in other;
- Corporate short-termism is the conscious decision (under external pressures or not) by management/boards to take actions that will bring benefits in the immediate future, knowing full well that these actions may prove eventually detrimental to the welfare of the company.

# EVIDENCE OF CORPORATE SHORT-TERMISM

- Survey of Graham, Harvey & Rajgopal in “The Economic Implications of Corporate Financial Reporting”, *Journal of Accounting and Economics*, 2005
- Brian J Bushee, “The influence of institutional investors on myopic R&D investment behavior” *The Accounting Review*; Jul 1998.
- Natalie Mizik, “The Theory and Practice of Myopic Management”, *Journal of Marketing Research*, Volume 47, Number 4, August 2010
- Dominic Barton and Mark Wiseman “Focusing Capital on the Long Term”, *Harvard Business Review*, January-February 2014.

«A *McKinsey Quarterly* survey of more than 1,000 board members and C-suite executives around the world to assess their progress in taking a longer-term approach to running their companies

The results are stark:

- 63% of respondents said the pressure to generate strong short-term results had increased over the previous five years.
- 79% felt especially pressured to demonstrate strong financial performance over a period of just two years or less.
- 44% said they use a time horizon of less than three years in setting strategy.
- 73% said they *should* use a time horizon of more than three years.
- 86% declared that using a longer time horizon to make business decisions would positively affect corporate performance in a number of ways, including strengthening financial returns and increasing innovation.»

Source: Dominic Barton and Mark Wiseman in *Harvard Business Review*, January 2014

# GOVERNANCE “IMPERFECTION”: A CRITICAL ISSUE

In widely held public corporations

- Board members are generally responsible, dedicated people operating in a framework of fastidious, punctilious governance;
- But boards, under current governance imperatives, cannot resolve the dilemma of “asymmetric information” that makes them vulnerable, that generates a “governance imperfection”.
- Over the years, various players have tapped into this governance imperfection; first private equity (known then as LBO) funds and more recently hedge funds;
- Institutional investors have also been active in demanding better *fiduciary* governance.

# CORPORATE SHORT-TERMISM: WHAT ARE THE CAUSES?

- Shifting beliefs about the purposes and responsibilities of the modern corporation; *from “stakeholder model” to “shareholder value maximization”*;
- Ownership structure of corporations: the dominance of widely-held, listed corporations; the gradual elimination of the board as buffer;
- Perverse incentives throughout the economic system, from corporate executives to management of institutional investors;
- The tyranny (or collusion) of quarterly guidance and analyst meetings;
- The pressures on corporate directors from “investors” and governance enforcers (ISS et al.);
- Tax policies favouring short-termism (stock options, capital gains, carried interest).

Source: Allaire and Firsirotu, *Black Markets and Business Blues*, 2009.

# A TYPICAL EXAMPLE OF GOVERNANCE FAILURE: THE LEHMAN BANKRUPTCY

«Although Lehman's management did not provide the Board with all available information concerning the risks faced by the firm in 2007 and early 2008, that fact is not surprising given the Board's limited role in overseeing the firm's risk management, and the extraordinarily detailed information available to management...

And in monitoring risk issues, the Board justifiably relied entirely on information provided by management.

... Under Delaware law, the directors are thereby immunized from personal liability.»

( **REPORT OF ANTON R. VALUKAS, EXAMINER , Lehman Bankruptcy , March 11, 2010, Page 185**)



# THE QUINTESSENCE OF GOVERNANCE “IMPERFECTION”

The board of Lehman did what it could; board members (several former CEOs of large corporations) exercised their business judgment, a judgment shaped by an experience totally foreign to the investment banking/trader business in the years 2000-2008.

They made decisions on the basis of their limited knowledge of the trading business and *the information provided to them by management.*

# ELIMINATING (REDUCING?) GOVERNANCE “IMPERFECTIONS”

In a corporate environment still characterized by many governance failures (or imperfections), three paths to reform:

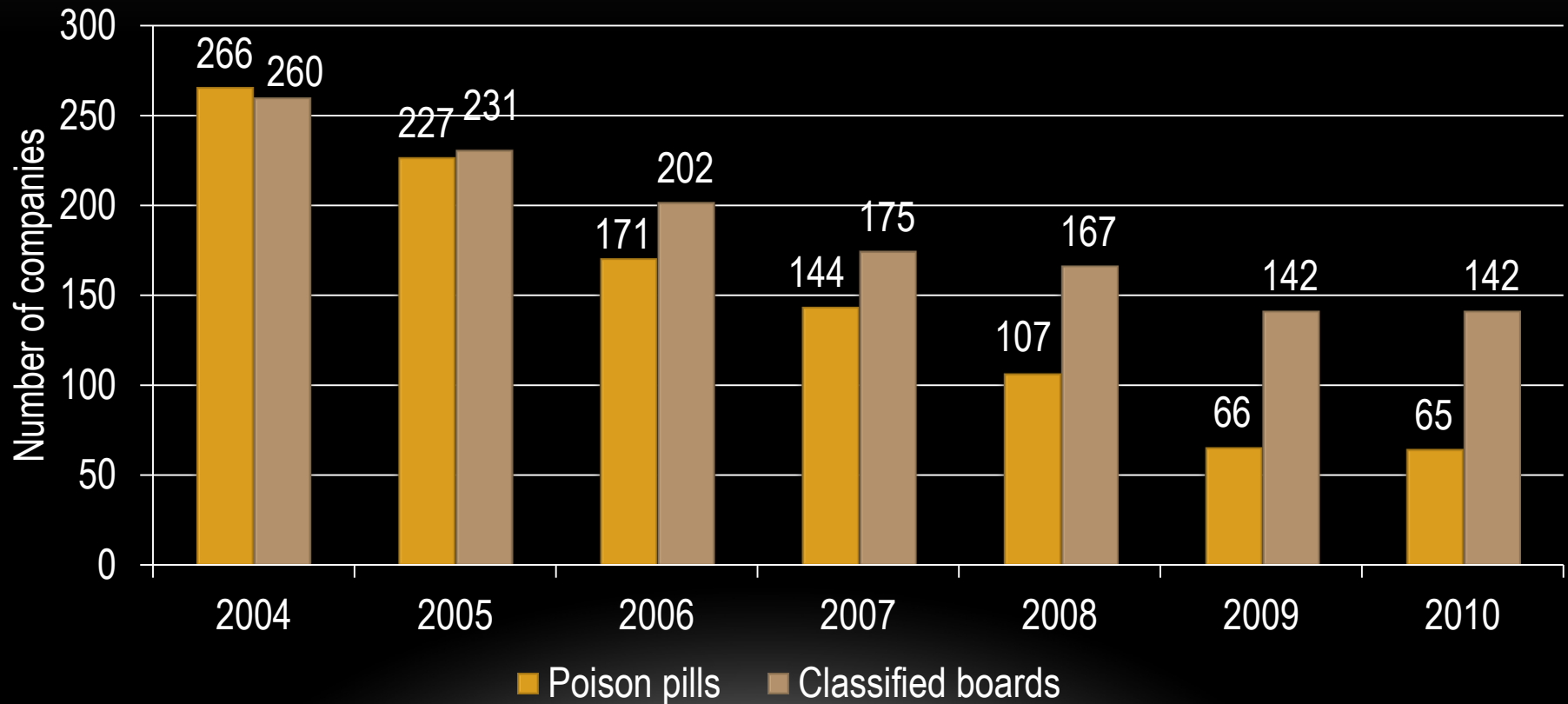
- The soft way of Institutional Investors; may soon reach its limit
- The hard way of Activist Hedge Funds; lucrative business but for whose ultimate benefit?
- Transformed governance with boards made up of “activist” members; less independence, more credibility on boards

# TWO FORMS OF ACTIVISM: Soft (Institutional) and Hard (Hedge Funds)

## **INSTITUTIONAL INVESTORS**

- Stringent fiduciary duties
- Highly diversified portfolio
- Small stakes in target companies
- No economic justification for an activist campaign
- Activism targeted at corporate governance guidelines
- “Exit” simpler than “voice”
- *Fairly short holding period*
- **Driven by governance and socio-political issues**

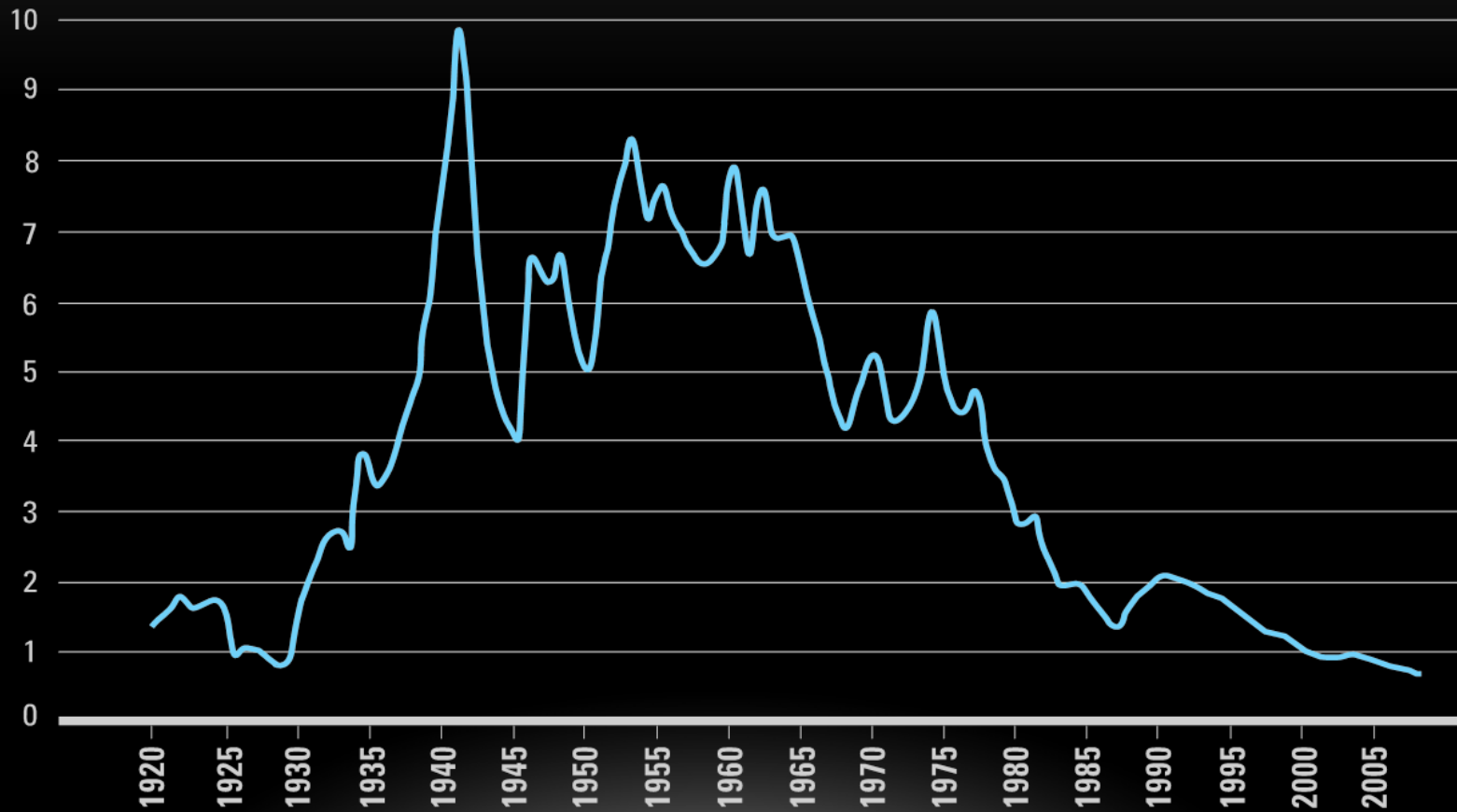
# SOFT ACTIVISM AT WORK: Poison pills and classified boards of S&P 500 companies, 2004-2010



Based on takeover defense trend analysis year end snapshot from 2004-2010

**SOME EVIDENCE  
OF INVESTOR SHORT-TERMISM  
...BUT NOT A VERY RECENT  
PHENOMENON**

# AVERAGE STOCK HOLDING PERIOD – NYSE 1920-2008



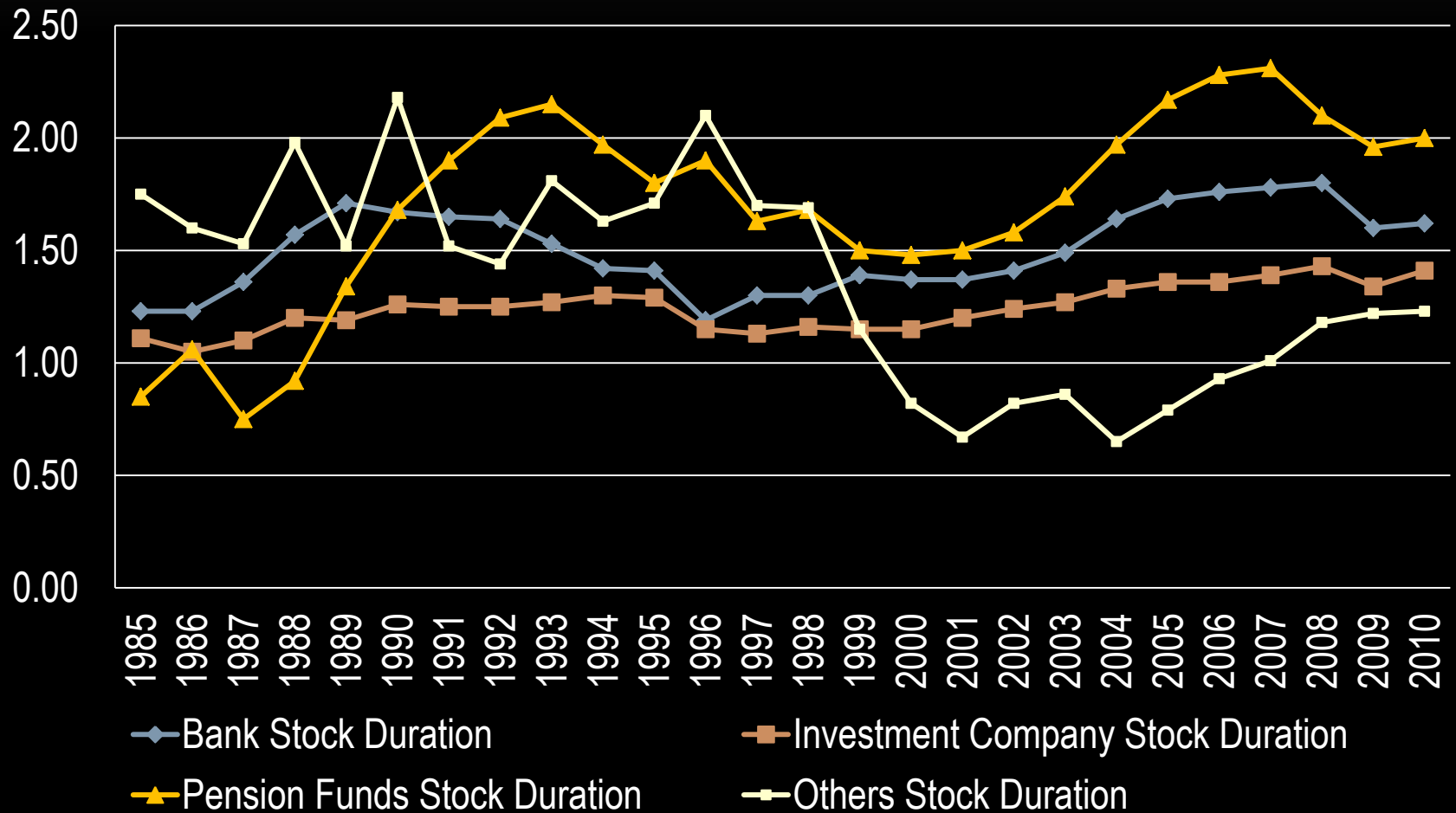
# MEDIAN STOCK HOLDING PERIOD FOR DIFFERENT CATEGORIES OF INVESTMENT FUNDS (IN YEARS)

Year	Banks: Stock Duration	Investment Companies: Stock Duration	Pension Funds: Stock Duration	Others: Stock Duration
1985	1.23	1.11	0.85	1.75
1990	1.67	1.26	1.68	2.18
1995	1.41	1.29	1.80	1.71
2000	1.37	1.15	1.48	0.82
2005	1.73	1.36	2.17	0.79
2010	1.62	1.41	2.00	1.23
Total	1.50	1.23	1.72	1.00

Source: Cremers, Pareek, and Sautner “Stock Duration and Misvaluation”, SSRN No.2190437, December 2012

# STOCK DURATION BY INSTITUTIONAL INVESTOR TYPE

Stock Duration by Institutional Investor Type from 1985-2010





# ROUND-TRIP TRADES BY HOLDING PERIOD

## FIFO ROUND-TRIP TRADES

Fund-level Cumulative Percentages (%)			
Holding Period		Money Manager	Pension Funds
At least	Less than	Median	Median
	1 day	0.13	0
1 day	1 week	1.17	0.31
1 week	1 month	6.11	3.54
1 month	2 months	14.46	9.55
2 months	3 months	23.21	16.15
3 months	4 months	29.96	23.38
4 months	5 months	36.91	30.25
5 months	6 months	42.85	36.34
6 months	9 months	58.44	52.36
<b>9 months</b>	<b>1 year</b>	<b>70.23</b>	<b>64.52</b>
1 year	<b>2 years</b>	<b>90.62</b>	<b>89.04</b>
2 years	3 years	97.03	96.61
3 years	4 years	99.18	99.24
4 years		100	100

# TWO FORMS OF ACTIVISM: Soft (Institutional) and Hard (Hedge Funds)

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## ACTIVIST HEDGE FUNDS

- Do the dirty work for institutional investors!
- Fewer regulatory constraints
- Better incentives to seek new strategies and generate higher returns
- Can depart from classic portfolio management principles
- Larger interests in fewer corporations
- Engage management and corporate boards and prepared to become hostile
- Encourage traditional investors to tag along
- **Driven strictly by financial returns**

# THE HARD ACTIVISM OF HEDGE FUNDS: WHAT DO ACTIVIST HEDGE FUNDS WANT?

- Selling the company, going private 23% to 30% of cases
- Unbundling – sale or spin-off of divisions, assets, etc. 18% to 32% of cases
- Disgorging cash - special dividends, share buy-back, debt restructuring 20% to 36% of cases
- Changing governance, strategy and/or management 30% to 40% of cases
- Pursue growth strategies 1% to 2% of cases

Source : Adapted from Bratton, 2006 / Brav et al., 2007

# TYPE OF ACTIVIST ENGAGEMENT OUTCOME

## Year of initial regulatory filing/press disclosure 2000-2010

	Board (replacement of CEO, Chairman, etc.)	Payout (share buybacks or increased/special dividends)	Restructuring (divestitures and spin-offs of non- core assets)	Takeover (target firm is acquired by a strategic buyer or PEF)	Total outcomes
Number of cases	486	293	271	308	1,358
% by type	<b>35.8%</b>	<b>21.5%</b>	<b>20.0%</b>	<b>22.7%</b>	<b>100%</b>

Source: Becht, M., J. Franks, J. Grant and H. Wagner. (2014) "The Returns to Hedge Fund Activism: An International Study". *European Corporate Governance Institute Working Paper Series in Finance*, No 402/2014.

# HEDGE FUND HOLDING PERIOD (CALENDAR DAYS) FOR COMPLETED SPELLS

Percentile	Hostile (Initial)	Non-hostile (Initial)	All Events
5%	11	23	22
25%	96	141	126
<b>50%</b>	<b>229</b>	<b>285</b>	<b>266</b>
75%	439	504	487
95%	840	1,273	1,235

Source: Brav, Jiang & Kim (2010), in *Hedge Fund Activism: A Review*

# INVESTMENT HORIZON OF ACTIVIST HEDGE FUNDS

Panel A : Investment horizon of hedge fund activists (in months)

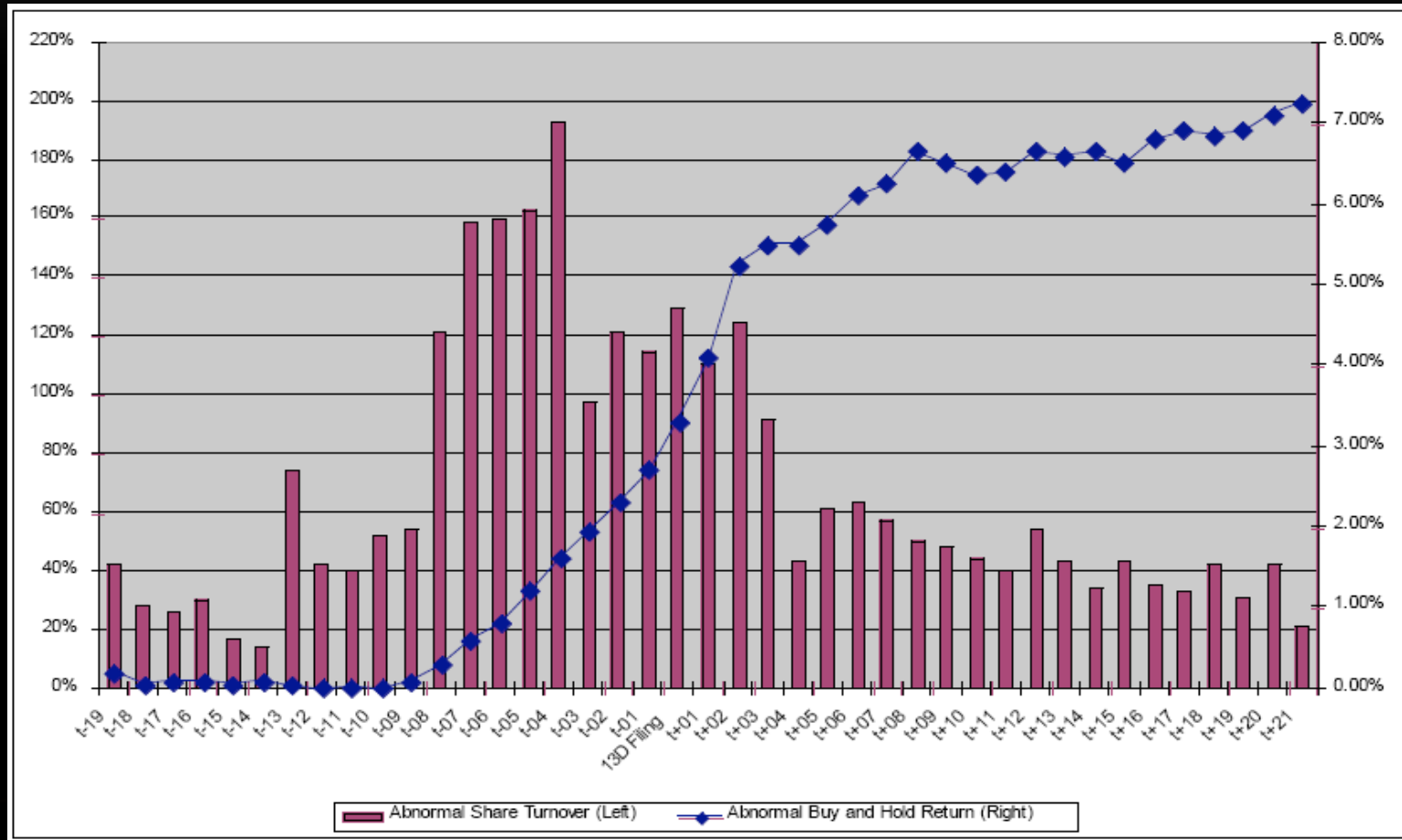
Percentile	25%	50%	75%	90%	Mean
Exit after initial filing	0	<b>5</b>	13	25	9.42
Exit after demand negotiations	2	<b>6.5</b>	16	27	10.48
Exit after board representation	7	<b>15</b>	27	41	19.43
Exit after proxy contest	10	<b>18</b>	34	64	25.78
Average (per campaign)	3	<b>9</b>	20	36	14.66

*Sample of 1,164 distinct campaigns involving 171 hedge funds and 1,023 unique targets, for the period 2000-2007*

# ACTIVIST HEDGE FUNDS

## Short-term impact

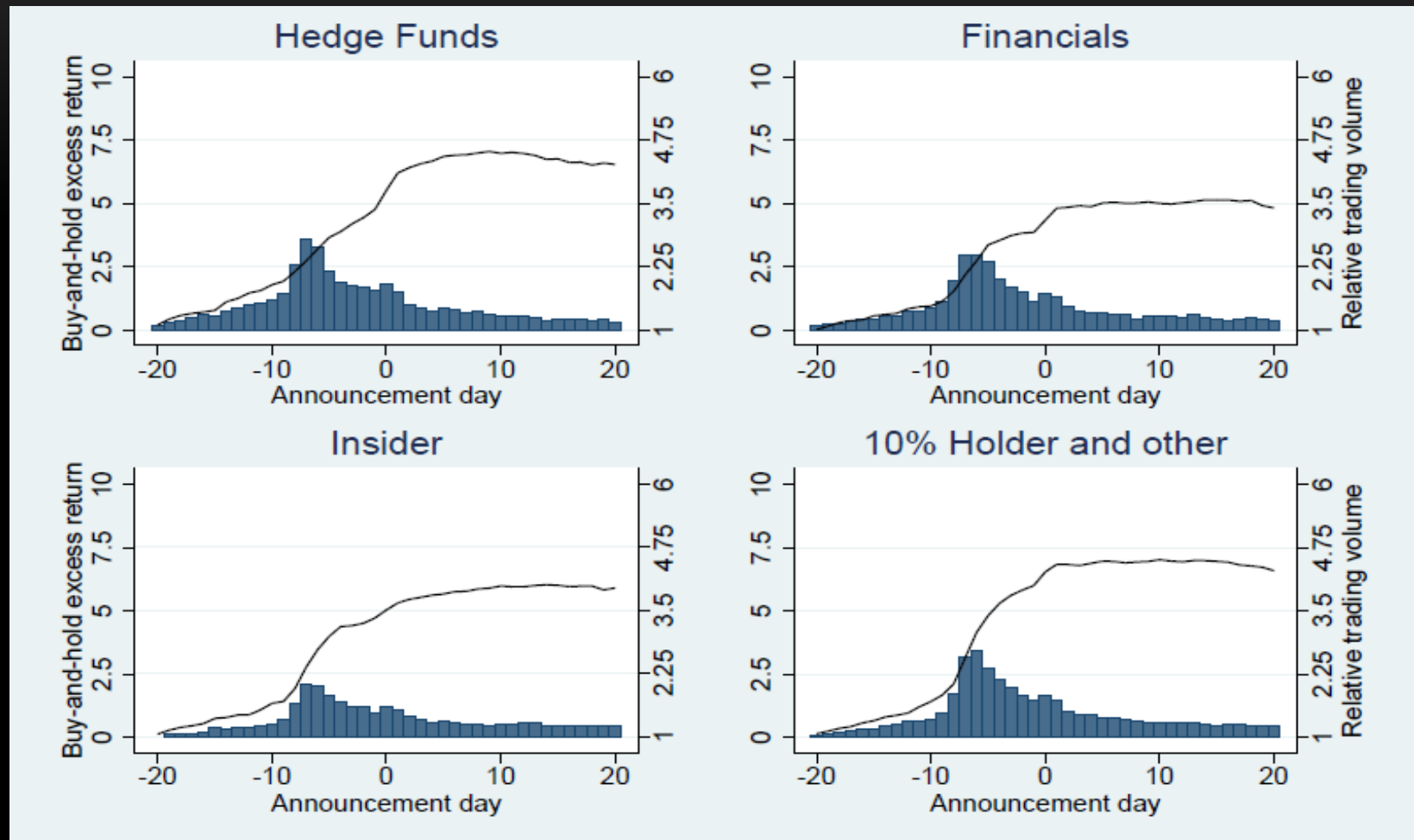
# MARKET RETURNS BEFORE AND AFTER SCHEDULE 13D FILINGS BY HEDGE FUNDS (+/- 20 DAYS)



Source: Alon Brav et al., "Hedge Fund Activism, Corporate Governance and Firm Performance," European Corporate Governance Institute (ECGI) Working Paper No. 139/2006, p. 23



# ABNORMAL RETURNS FOR DIFFERENT 13-D FILERS



**Sample of 3,265 hedge fund events and 44,596 non-hedge fund events, period 1985-2012**

Source: Ulf von Liliendorf-Toal and Jan Schnitzler "What is special about Hedge Fund Activism? Evidence from 13-D filings" Available on SSRN, June 2014.

# ACTIVIST HEDGE FUNDS

## Long-term impact

- Several studies on the topic
- The best known and most quoted (op-ed in WSJ, etc.):

*Bebchuk, Brav and Jiang, 2013*

# THE MYTH OF HEDGE FUNDS AS 'MYOPIC ACTIVISTS'

*BEBCHUK'S OP-ED IN THE WALL STREET JOURNAL (AUGUST 7, 2013)*

- *Our study uses a data set consisting of the full universe of approximately 2,000 interventions by activist hedge funds from 1994–2007.*
- *During the five-year period following the intervention month, operating performance relative to peers improves consistently.*
- *Contrary to the belief that the market fails to appreciate the long-term consequences of activism, long-term shareholders don't suffer any negative abnormal returns during the subsequent five-year period.*

# INDUSTRY-ADJUSTED OPERATING PERFORMANCE: PRE- AND POST-INTERVENTION

Panel A : Industry-adjusted ROA (benchmark = industry average)						
	t: Event Year	t+1	t+2	t+3	t+4	t+5
Average	-0.028	-0.013	-0.010	-0.004	-0.005	-0.009
Median	-0.005	-0.002	0.001	0.000	0.005	0.002
Observations	1,584	1,363	1,187	1,055	926	694

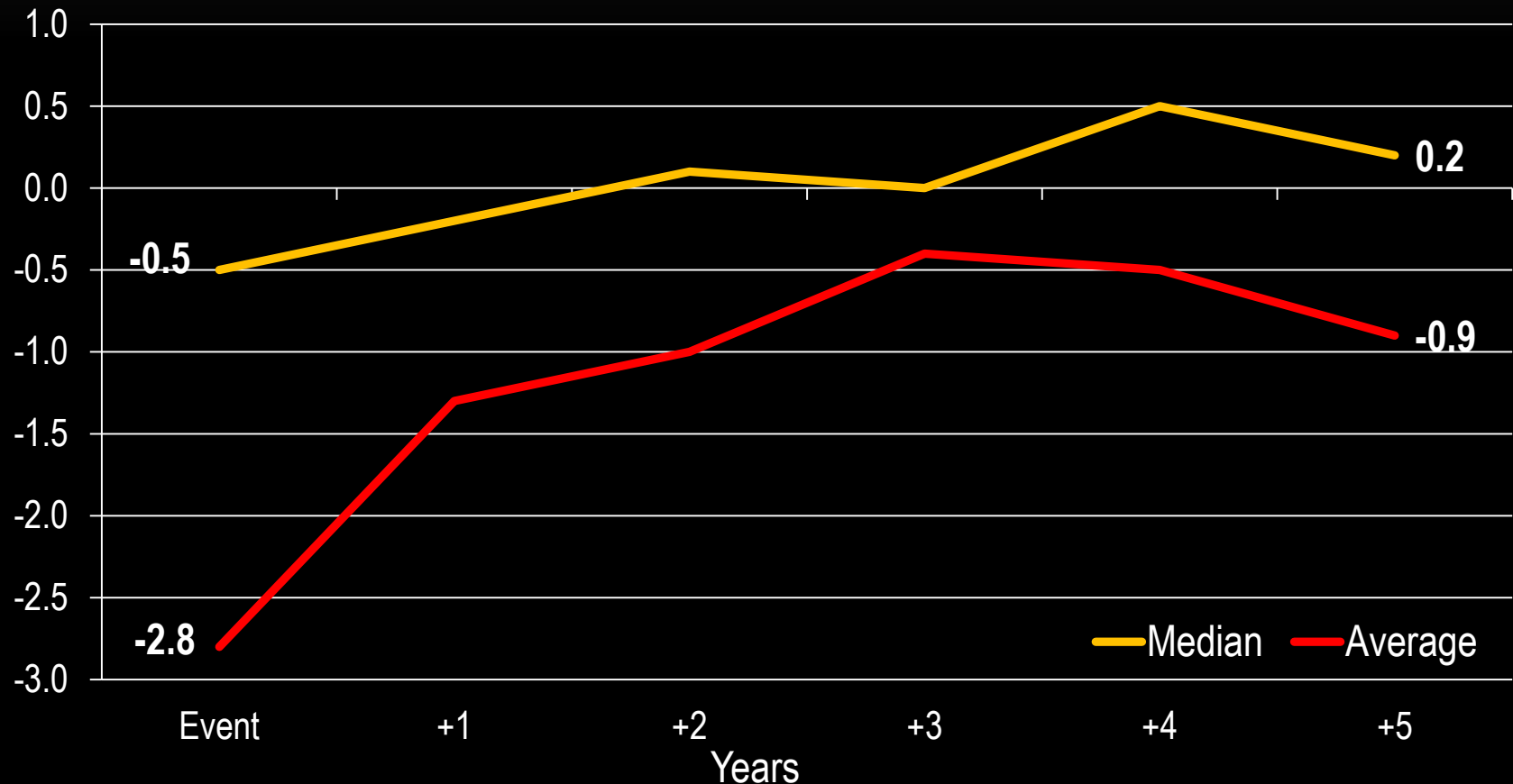
Panel B : : Industry-adjusted Tobin's Q (benchmark = industry average)						
	t: Event Year	t+1	t+2	t+3	t+4	t+5
Average	-1.507	-1.369	-1.377	-1.329	-0.984	-0.935
Median	-0.748	-0.614	-0.540	-0.547	-0.470	-0.420
Observations	1,611	1,384	1,206	1,076	942	710

Source: Excerpt from Table 3 of Bebchuk, Brav and Jiang, 2013, p.9.

# BEBCHUK, BRAV & JIANG (2013)

## “THE LONG-TERM EFFECTS OF HEDGE FUND ACTIVISM”

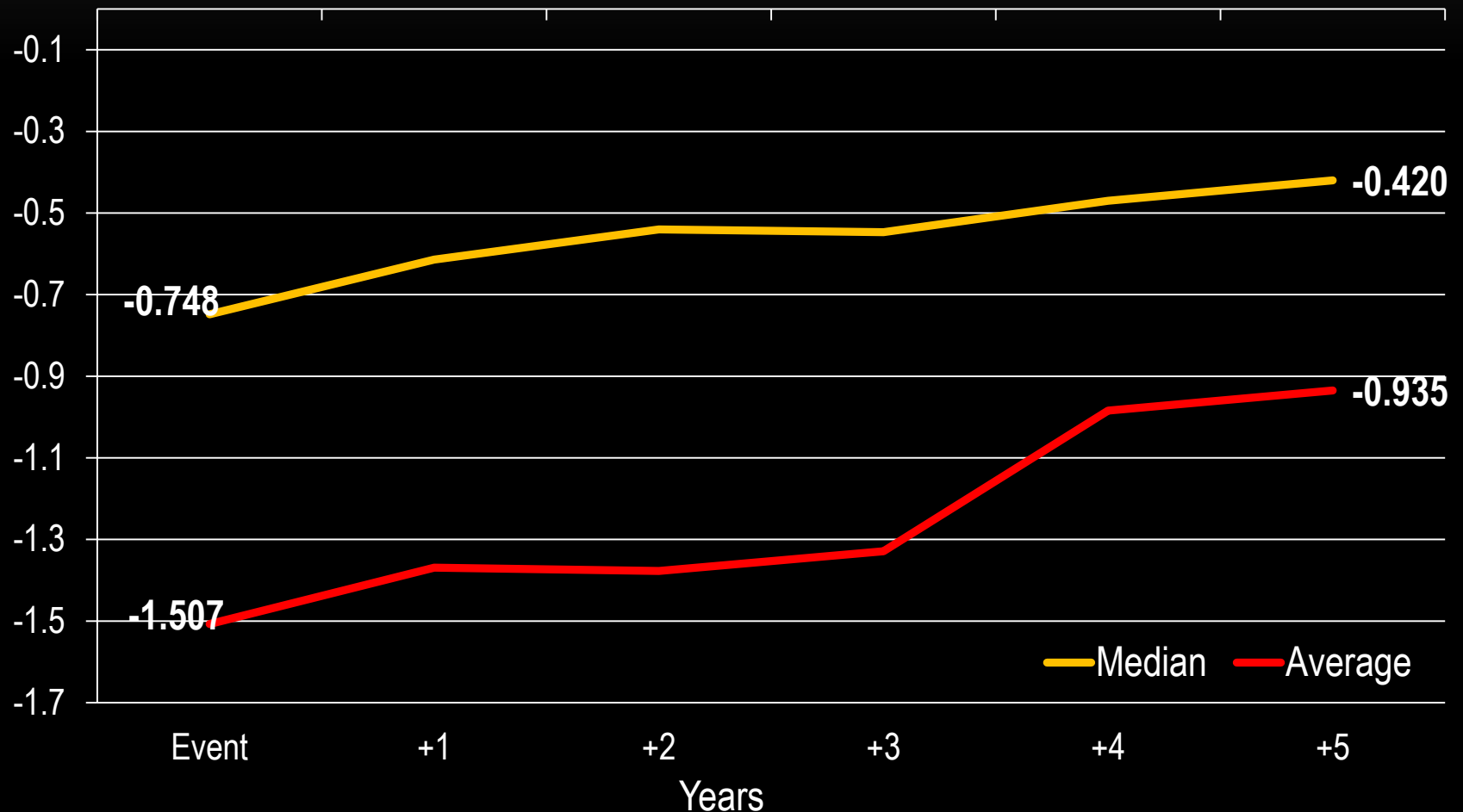
### INDUSTRY-ADJUSTED ROA



# BEBCHUK, BRAV & JIANG (2013)

## “THE LONG-TERM EFFECTS OF HEDGE FUND ACTIVISM”

### INDUSTRY-ADJUSTED TOBIN’S Q

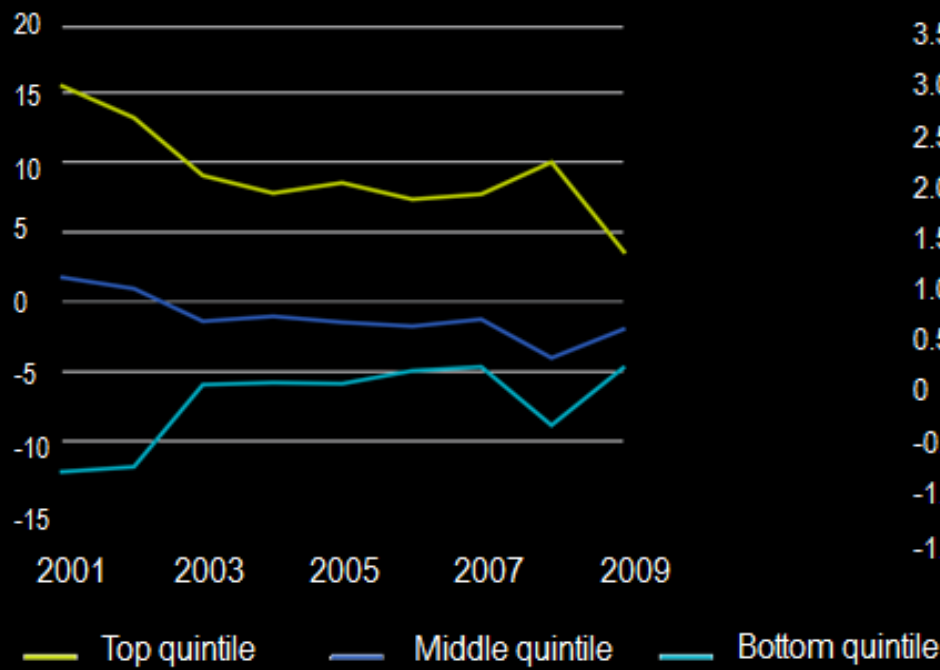


# MARKET AND ECONOMIC FORCES DRIVE CONVERGENCE OF PERFORMANCE TOWARDS THE MEAN

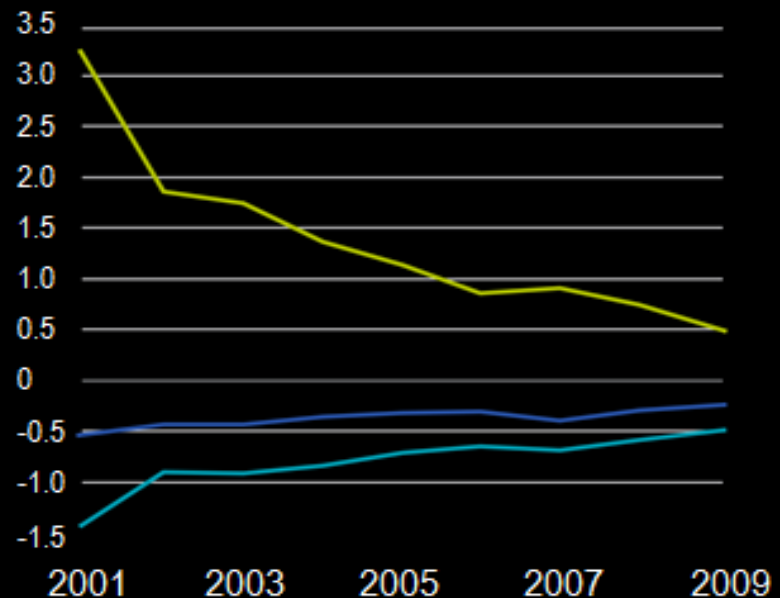
Markets drive a reversion to mean performance

Performance cohorts based on position in 2001 relative to mean, n = 743\*

Return on invested capital (ROIC), %

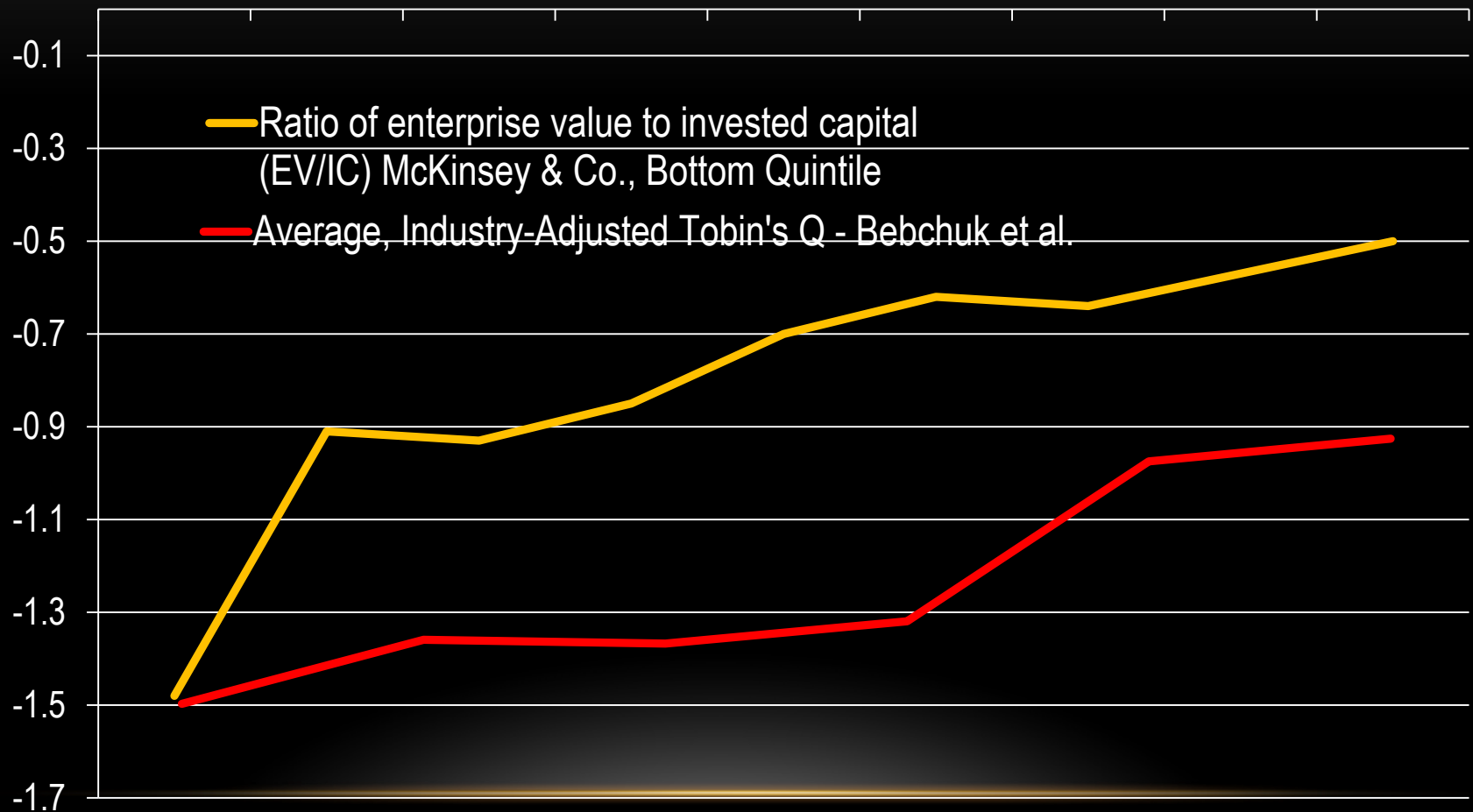


Ratio of enterprise value to invested capital (EV/IC)



\*Sample of largest 1,200 nonfinancial US-listed companies in 2009 was narrowed to 743 that were also listed in 2001

# CONVERGENCE OF PERFORMANCE TOWARDS THE MEAN – SUPERPOSITION OF MCKINSEY'S EV/IC BOTTOM QUINTILE AND BEBCHUK *ET AL.* INDUSTRY-ADJUSTED TOBIN'S Q





# DIFFERENT STUDIES, DIFFERENT NUMBER OF CASES

	Bebchuk, Brav, Jiang (2013)	Brav, Jiang and Kim (2012) <sup>a</sup>	Brav, Jiang and Kim (2013) <sup>b</sup>	Boyson and Mooradian (2007)	Clifford (2008) <sup>d</sup>	Klein and Zur (2011) <sup>e</sup>	Greenwood and Schor (2009) <sup>f</sup>
1994	10		8	13 <sup>c</sup>		5	10
1995	37		29	20		21	10
1996	99		83	34		28	30
1997	212		178	91		38	66
1998	161		137	42	82	41	74
1999	118		98	34	62	42	90
2000	120		98	24	63	44	84
2001	96	92	83	21	71	36	83
2002	134	120	118	33	94	50	89
2003	127	122	112	43	106	61	67
2004	148	144	133	42	118	70	87
2005	237	234	210	21	192	98	153
2006	269	252	259			101	137
2007	272	208	297				

## DIFFERENT STUDIES, DIFFERENT NUMBER OF CASES

*“There are a considerable number of cases in Brav et al [the data base used for the Bebchuk, Brav and Jiang study] that are not in our database and vice versa. We examine the first 80 cases alphabetically from a combination of Brav et al and our sample and find that in 27 cases there is overlap in the two data bases; **19 cases are in our sample but not in Brav et al, 34 cases are in Brav et al but not in our sample. Reasons for non-overlapping samples appear to be differences in exclusion criteria and search techniques.**”*

(Emphasis added)

Becht, M., J. Franks, J. Grant and H. Wagner. (2014) “The Returns to Hedge Fund Activism: An International Study”. *European Corporate Governance Institute Working Paper Series in Finance*, No 402/2014.

# Market Capitalization of Target Companies in the Brav, Jiang and Kim Database

<i>Sample of 2,624 fund-target firm pairs, period 1994-2011</i>	Market capitalization, in millions of dollars
Mean	835.3
Median	<b>134.6</b>
Average Difference with Matched Firms	-1,906.1

Source: Brav, A. W. Jiang and H. Kim. "Hedge Fund Activism: Updated Tables and Figures". September 2, 2013

# SOME OBSERVATIONS ON THE BEBCHUK ET AL. STUDY

- The authors have not demonstrated that activist hedge funds, per se, create lasting, long term value. Their sample data, with all its limitations, show no longer-term reversal of performance.
- They show that “activist” hedge funds produce short-term «abnormal» return; but the same result is observed for most 13D filers.
- When activist hedge funds bring some lasting value for shareholders, it often takes the form of wealth transfer from employees and debt holders rather than wealth creation.

# HEDGE FUNDS: VALUE CREATION OR VALUE TRANSFER?

“Overall, results in this section suggest that target firm workers do not share in the improvements associated with hedge fund activism. They experience a decrease in work hours and ***stagnation in wages***, while their productivity improves significantly.

Moreover, the relative decrease in productivity-adjusted wages from above-par levels suggests that ***hedge fund activism facilitates a transfer of “labor rents” to shareholders which may account for part of the positive abnormal return at the announcement of hedge fund interventions.***”

(Brav, Jiang et al, 2013, p.22, emphasis added)

# HEDGE FUNDS AND VALUE TRANSFER FROM BOND HOLDERS

- *...we find that hedge fund activism significantly reduces bondholders' wealth... Confrontational campaigns and the acquisition of at least one seat on the target's board elicit more negative bond returns. We also find an expropriation of wealth from the bondholder to the shareholder.*

Source: "The Impact of Hedge Fund Activism on the Target Firm's Existing Bondholders", Klein and Zur (2010)

# MOODY'S ABOUT SHAREHOLDER ACTIVISM

“Our finding that its [shareholder activism] effects on the creditworthiness of Moody’s-rated issuers is ***almost universally negative***, even if only moderately.”

***“As short-term shareholder activists have become more influential, we have observed numerous examples of concessions to activists that have eroded credit quality contributing to downgrades.”***

# STANDARD & POOR'S – SPIN-OFFS OFTEN COME AT A PRICE TO CREDITORS

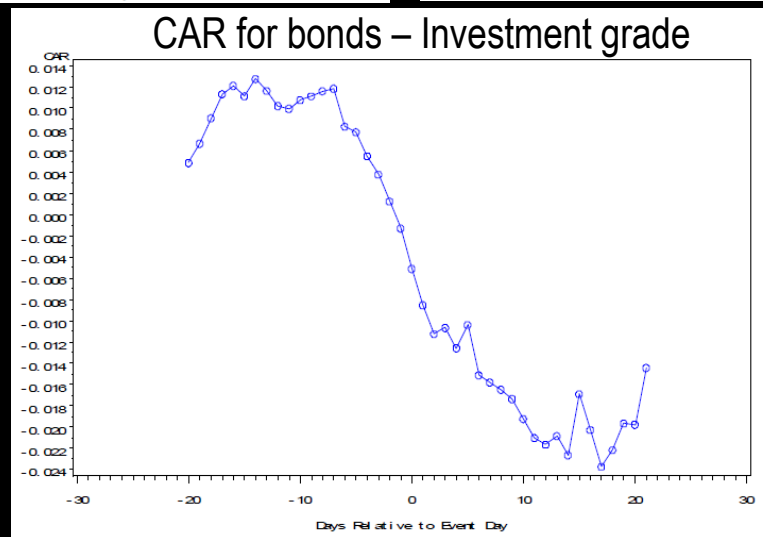
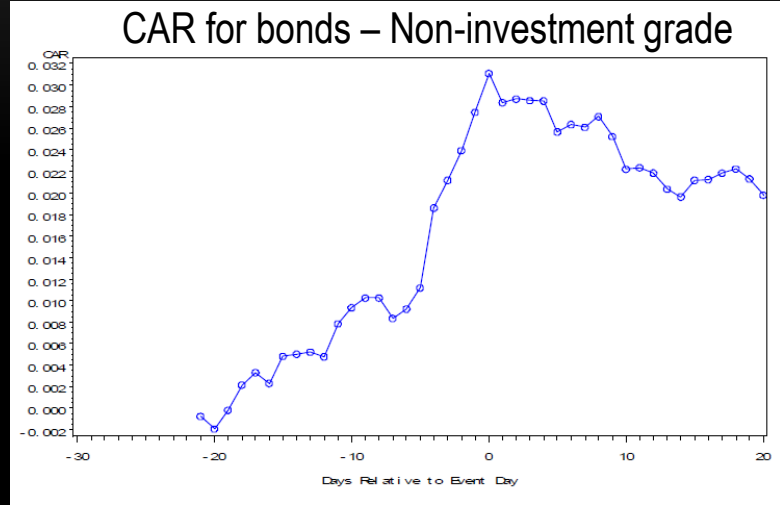
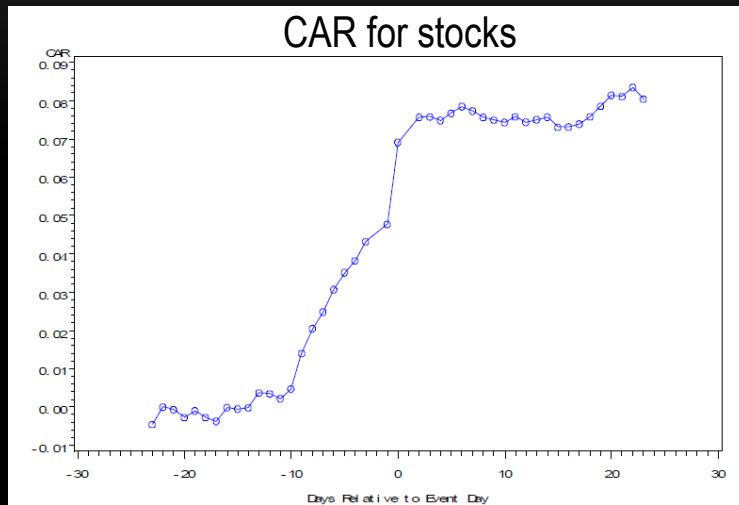
“Since Aug. 1, 2013, Standard & Poor's has lowered or placed on CreditWatch with negative implications ***one-third*** of its ratings on companies that initiated spin-off transactions.”

“Longer-term credit quality for companies that execute a spin-off has deteriorated as well, ***since about 40% of these issuers now have lower ratings.***”

Source: Standard & Poor's press release of the report titled “Spin-Offs, On The Rise Again In The U.S., Can Signal Weaker Credit Quality For Parent Companies”, October 10, 2014



# CUMULATIVE ABNORMAL RETURNS OF TARGET BONDS AND STOCKS SUBJECT TO HEDGE FUND ACTIVISM



Activism sample of  
1,332 target firms,  
for the period  
1996-2008

From trading days -22  
to trading day +22,  
where day 0 is the  
event day

# SOME FURTHER OBSERVATIONS ON BEBCHUK *ET AL.*

- “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.
- 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.

# TWO OTHER RECENT STUDIES PURPORTING TO SHOW POSITIVE LONG-TERM EFFECTS OF HEDGE FUND ACTIVISM

- Gow, I. D., S-P. S. Shin and S. Srinivasan. “*Activist Directors: Determinants and Consequences*”. *Harvard Business School Working Papers*, #14-120, June 2014.
- Goodwin, S. “*Myopic Investor Myth Debunked: The Long-Term Efficacy of Shareholder Advocacy in the Boardroom*”. Available at SSRN, October 2014.

# GOW, I. D., S-P. S. SHIN AND S. SRINIVASAN STUDY (2014)

“Activist directors appear to be associated with significant strategic and operational changes in target firms...

*We find evidence of increased divestiture, decreased acquisition activity, higher probability of being acquired, lower cash balances, higher payout, greater leverage, higher CEO turnover, lower CEO compensation, and reduced investment.”*

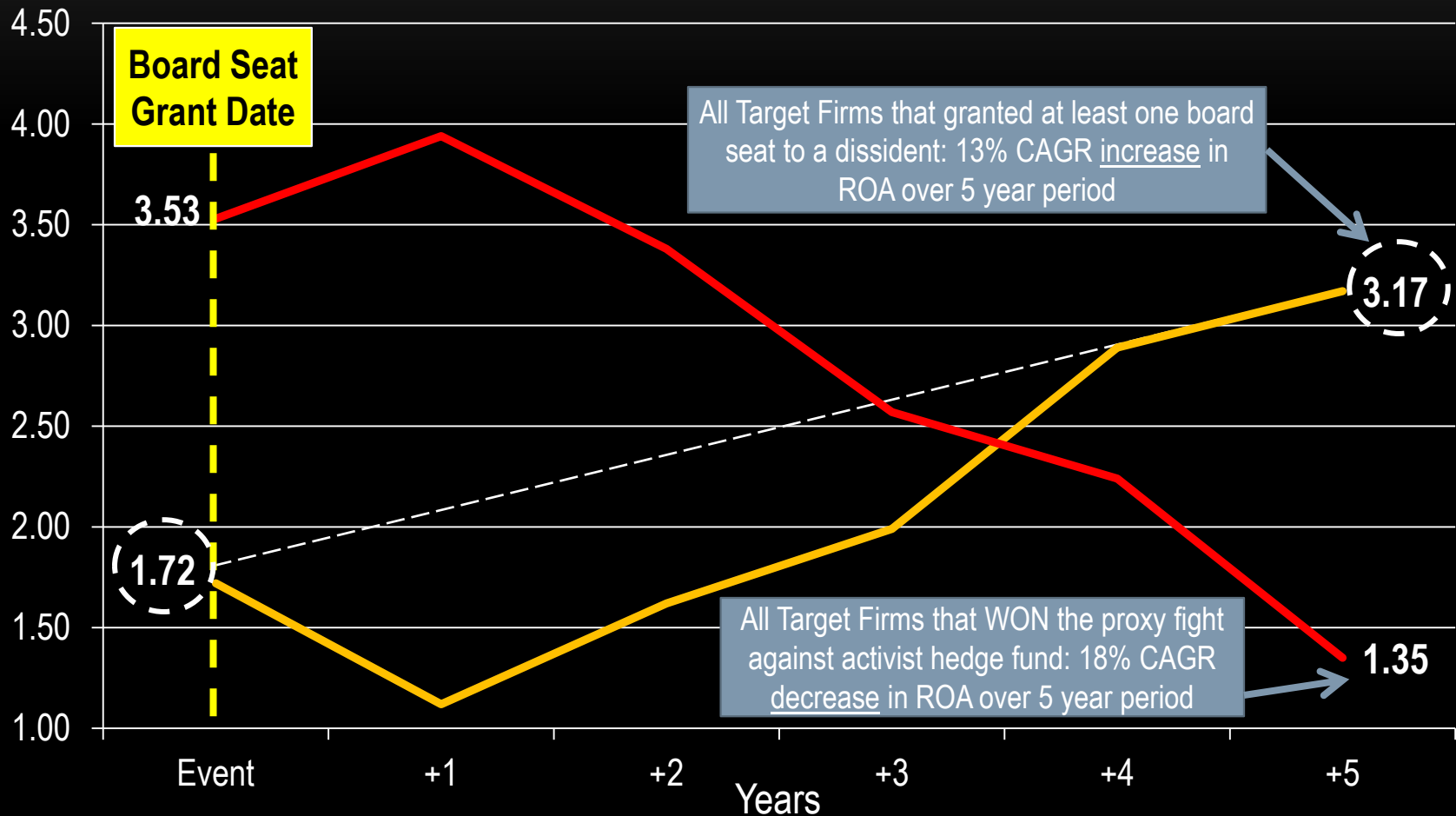
- These authors view all of these as positive long-term results from hedge fund activism!!! Yet, what about return to shareholders?

# GOW *ET AL.*-STOCK RETURNS BY CATEGORY OF ACTIVISM, FROM ACTIVISM ANNOUNCEMENT (MONTH $T$ TO MONTH $T + 36$ )

Category of activism	Number of events	Raw returns	Size-adjusted returns	Fama-French three-factor adjusted returns
Non-board related activism events	1,089	67.6%	45.9%	-0.9%
Activists demanded, <i>but did not win, board seats</i>	456	135.2%	100.1%	4.8%
Activists were granted one or more board seats	424	24.1%	0.1%	-5.1%

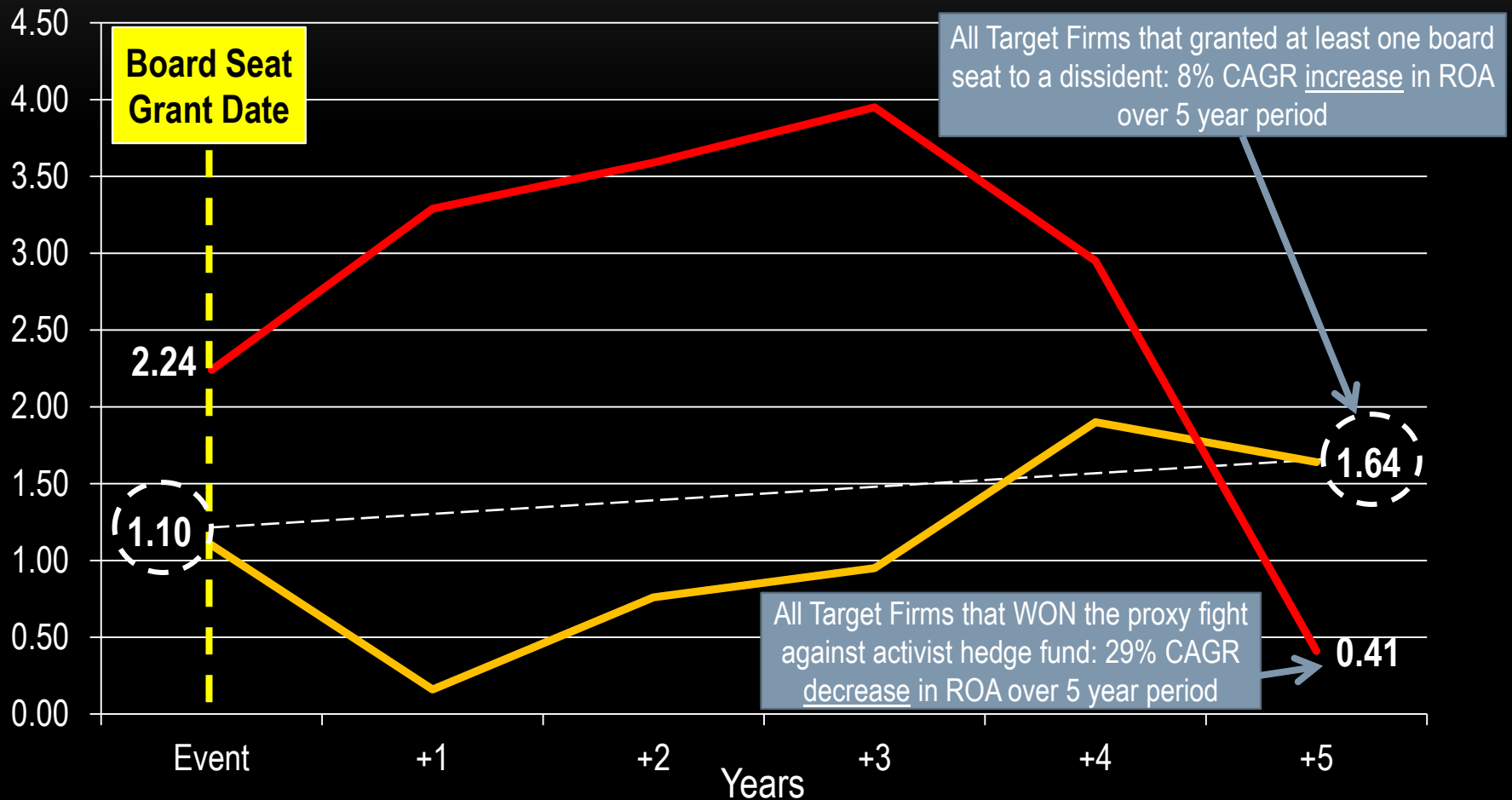
Source: Gow, I. D., S-P. S. Shin and S. Srinivasan. "Activist Directors: Determinants and Consequences". *Harvard Business School Working Papers*, #14-120, June 2014.

Goodwin, S. "Myopic Investor Myth Debunked: The Long-Term Efficacy of Shareholder Advocacy in the Boardroom, 2014 - THE ROA (MEDIAN, AS PER GRAPH 3, P.24)..."



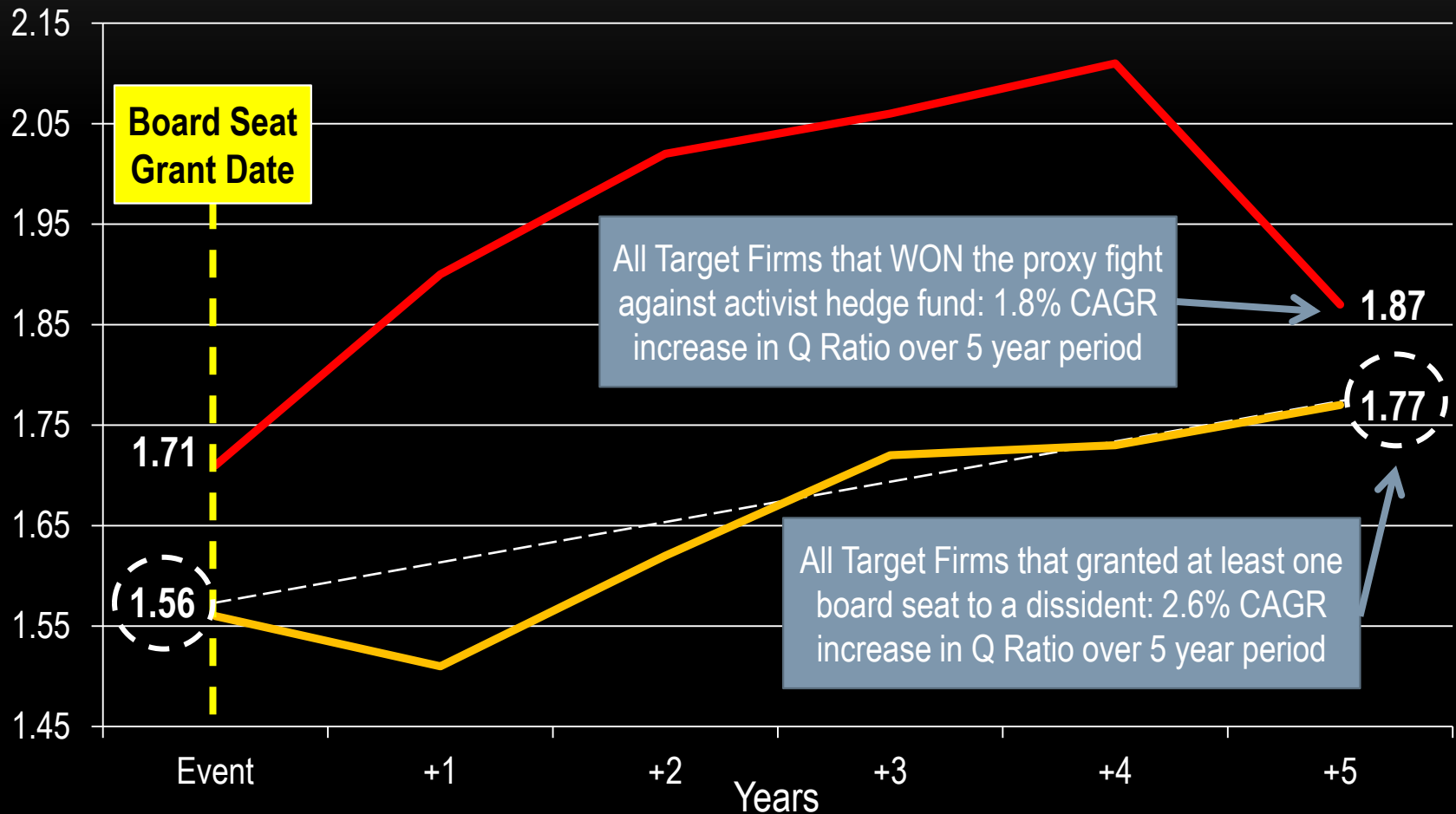
Goodwin: treatment group of 448 hedge fund wins and 73 management wins, for the period 1996-2013

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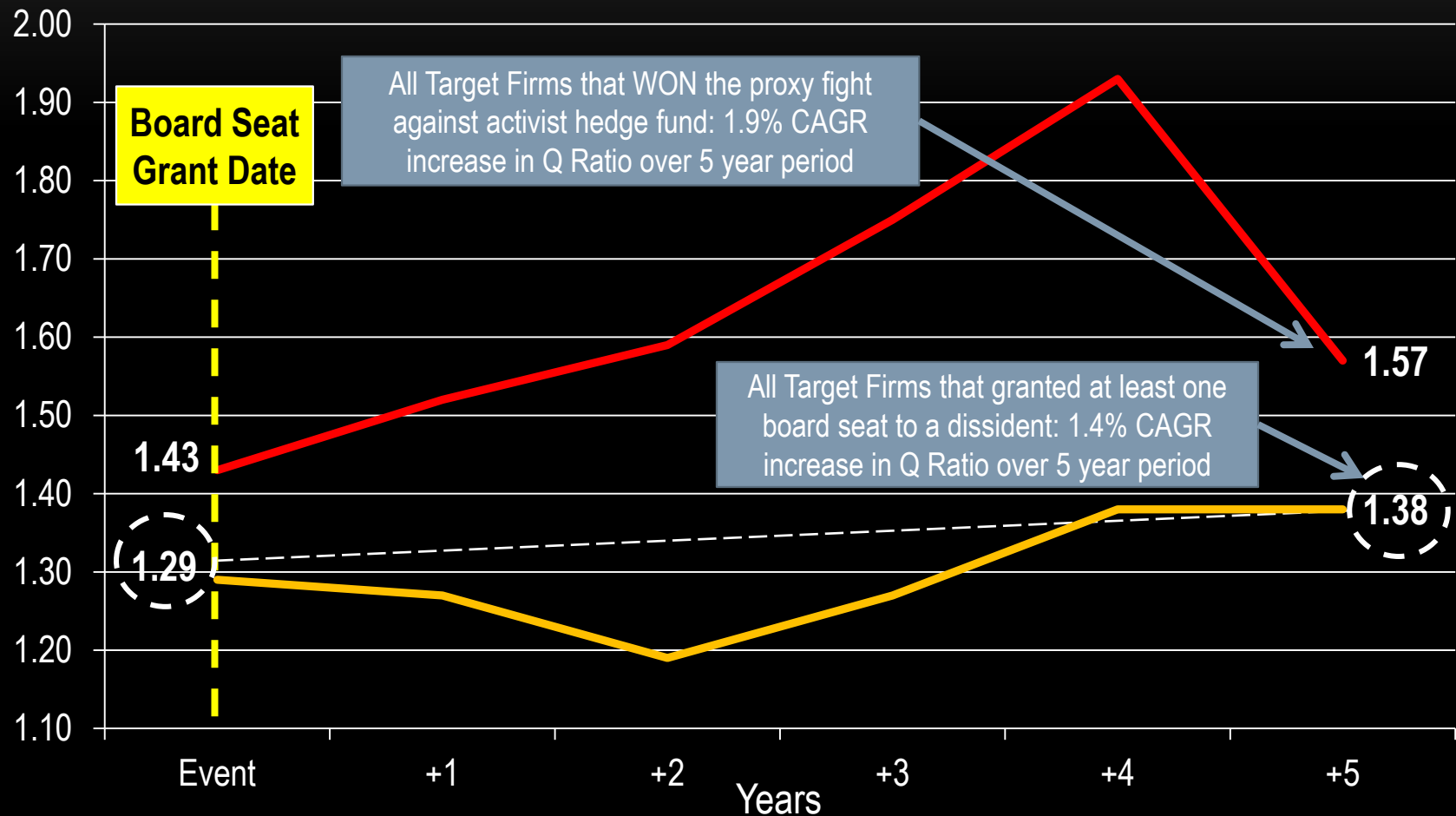
Goodwin, S. *“Myopic Investor Myth Debunked: The Long-Term Efficacy of Shareholder Advocacy in the Boardroom, 2014 - THE Q RATIO (MEAN, AS PER GRAPH 4, P.25) ...*



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# Goodwin, S. "Myopic Investor Myth Debunked: The Long-Term Efficacy of Shareholder Advocacy in the Boardroom, 2014 - THE Q RATIO (MEDIAN, GRAPH NOT PRESENTED)..."



Goodwin: treatment group of 448 hedge fund wins and 73 management wins, for the period 1996-2013

# SPILOVER EFFECTS OF ACTIVISM

“We document strong industry persistence of activism, which is seen as a threat to yet-to-be-targeted firms in the industry.

[O]ur results demonstrate *positive* real externalities of hedge fund activism, establishing that the impact of activism reaches beyond the firms being targeted and may have been underestimated in previous studies. [...] We show that managers rationally respond to the threat of activism in the way suggested by the anecdotal evidence.”

Source: Gantchev, N., O. Gredil and C. Jotikasthira. “Governance under the Gun: Spillover Effects of Hedge Fund Activism”, *available on SSRN*, March 2014, pp.3-4.

# SPIILLOVER EFFECTS OF ACTIVISM

“[T]his study shows that hedge fund activism has a preventive effect. [...] In proactive response to an increase in the likelihood of hedge fund intervention, *firms cut CEO pay, reduce cash holdings and leverage, limit capital investment and R&D expenses, and raise shareholder distributions and CEO turnover. As a result of these policy improvements, return on assets increases significantly.*

[B]y showing that hedge fund activism is an effective and viable mechanism for corporate governance, the study allows policymakers to make more informed decisions as they face heightened pressure to increase hedge fund regulations.”

Source: Zhu, H. “The Preventive Effect of Hedge Fund Activism”, *available on SSRN*, November 2013, pp.36-37.

# LET'S IMAGINE THE INDUSTRIAL STRUCTURE RESULTING FROM GENERALIZED HEDGE FUND MINISTRATIONS

- ...whether from actual attacks by an increasing number of hedge funds or from pro-active, preventive moves by corporations...

We would witness the following on a massive scale (if we believe the academic advocates of hedge funds):

*increased divestiture, decreased acquisition activity, higher probability of being acquired, lower cash balances, higher payout, greater leverage, higher CEO turnover, lower CEO compensation, and reduced investment (Gow, et al., 2014)*

*Firms cut CEO pay, reduce cash holdings and leverage, limit capital investment and R&D expenses, and raise shareholder distributions and CEO turnover (Zhu, 2013)*

**That is a fairly dismal world,  
shorn of long-term investments,  
of concern for any stakeholder  
other than shareholders.**

**Corporate management, already  
pushed to short-termism, would  
be driven to implement hedge  
funds' favorite initiatives...**

# THE ESSENTIAL FACILITATORS OF ACTIVIST HEDGE FUNDS

- Public pension funds supplying money to activists and supporting, more or less tacitly, their initiatives;
- Institutional investors and their soft activism targeting any and all defenses of boards against unwanted takeovers and pushing for a shareholder-centric form of governance;
- Proxy advisory firms as cheer-leaders of activist hedge funds...

# THERE ARE SEVERAL POTENTIAL COUNTERMEASURES TO THE HEDGE FUND BRAND OF ACTIVISM

- Institutional investors could adopt a longer term perspective for their holding, refusing to support the “hard” activism of hedge funds and recognizing the responsibility of public corporations to multiple stakeholders; they could, as per Calpers, divest of hedge funds;

# A COUPLE OF ACID TESTS COMING UP FOR INSTITUTIONAL INVESTORS

- Valeant cum Pershing Square v. Allergan
- PepsiCo v. Trian Fund

**See for an analysis of a successful case:** Allaire, Y. and F. Dauphin (2014). “Why was Pershing Square so successful at Canadian Pacific Railway?”, IGOPP.



INDRA NOOYI, CEO OF PEPSICO (2010):  
“COMPANIES CANNOT SIMPLY BE DRIVEN  
BY THE NEEDS OF SHAREHOLDERS”

“Companies have to think of themselves as serving stakeholders, they have to worry a lot about their cost to society. How do you make sure that as a company everything you do serves the next generation, serves communities, serves you employees better?”

Source: The Telegraph, *PepsiCo chief executive Nooyi brings in healthy profits in lean times*, February 1<sup>st</sup> 2010

Source: Allaire, Y. and M. Firsirotu (2011). *A Capitalism of Owners*, IGOPP, 184p.

# REACTIONS TO PEPSICO'S LOWERING OF EPS GUIDANCE IN JULY 2011

“Is she ashamed of selling carbonated sugar water?”

*(Wall Street Journal, July 28<sup>th</sup> 2011)*

“Pepsi faced criticism from analysts for neglecting its carbonated beverage business and **focusing too heavily on healthier products.**”

(emphasis added)

*(Financial Times, July 22<sup>nd</sup> 2011)*

“Ms. Nooyi set the company on a healthier course... virtuous this may be, but it has not been good for the bottom line.”

*(The Economist, October 15-21, 2011)*

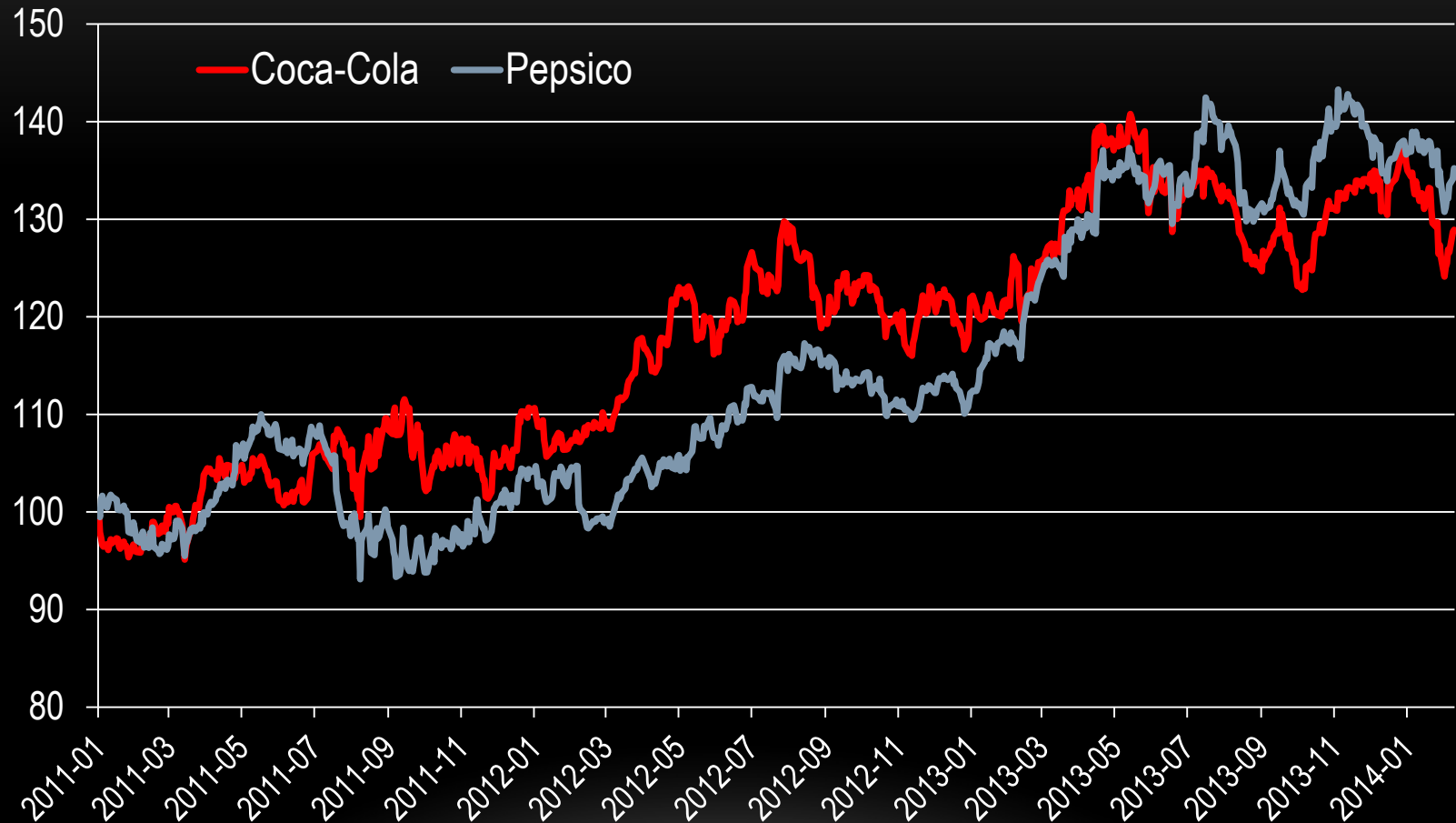
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Source: Allaire, Y. and M. Firsirotu (2011). *A Capitalism of Owners*, IGOPP, 184p.

# NELSON PELTZ AND PEPSICO

- In July 2013, Nelson Peltz, the activist hedge fund manager, announced that his Fund “Trian” beneficially owned in excess of \$1.3bn of PepsiCo shares.
- Peltz then issued a 59-page white paper making the point that “*the status quo is unsustainable*”.
- Peltz proposes that PepsiCo be split in two stock-traded companies: BeveragesCo and SnacksCo.
- In his estimation, such a strategic move would produce a 25% return for investors over 2.5 years.

# PEPSICO VS. COCA-COLA SINCE 2011 (BASIS 100)



# INDRA NOOYI REITERATES HER MESSAGE

Performance with Purpose is PepsiCo's recognition that the company's success is inextricably linked to society's success. In order to do well by our shareholders, we also have to take into account the needs and concerns of a wide range of stakeholders. *If our financial success comes at the expense of the environment, our consumers or our communities, we will not be viable in the long run.*

*Indra K. Nooyi, Letter to shareholders,  
PepsiCo's 2013 Annual Report*

Is she right or is she the forlorn  
defender of a bygone epoch?

Will institutional investors support  
her strategy or will they side  
with the hedge fund?

# THERE ARE SEVERAL POTENTIAL COUNTERMEASURES TO THE HEDGE FUND BRAND OF ACTIVISM

- Institutional investors could adopt a longer term perspective for their holding, refusing to support the “hard” activism of hedge funds and recognizing the responsibility of public corporations to multiple stakeholders;
- **Different forms of ownership and control: dual class, time-phased voting, etc.; *imitate what private equity funds and hedge funds do when they go public!***

# DUAL CLASS OF SHARES\* MAKES COMPANIES OUT OF REACH OF “ACTIVIST” HEDGE FUNDS

- Berkshire Hathaway; Alibaba; Google; Facebook; Groupon; Expedia, UPS; Tyson; Ford, Nike, etc.
- The NY Times; News Corp; CBS, Comcast, etc.
- *...and those you would not expect, given their devotion to unfettered capitalism and shareholder sovereignty...*
- Blackstone; KKR; Apollo; Pershing Square Holdings, Third Point, etc.

*\*But should include, as in Canada, a “coat-tail” provision so that control cannot be sold without the “minority” shareholders benefiting equally.*



# THERE ARE SEVERAL POTENTIAL COUNTERMEASURES TO THE HEDGE FUND BRAND OF ACTIVISM

- Institutional investors adopting a longer term perspective for their holding and refusing to support the “hard” activism of hedge funds
- Different forms of ownership and control: dual class, time-phased voting; imitate what private equity funds and hedge funds do when they go public!
- **Transformed governance: respond to hedge fund activism with *board activism*; less independence, more credibility on boards to do what’s right for the long-term welfare of the company.**

(See Allaire, Y. and M. Firsirotu (2013). “On Becoming an Activist Board! Sketch of a Corporate Governance that Creates Value”, Working Paper available on SSRN, 23p.

# DOES HEDGE FUND «ACTIVISM» CREATE LONG TERM SHAREHOLDER VALUE?

PRESENTATION AT THE ANNUAL MEETING OF  
THE CENTER FOR CORPORATE GOVERNANCE  
CONFERENCE BOARD OF NEW YORK

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November 14<sup>th</sup> 2014