

DOES SHAREHOLDER ACTIVISM BY HEDGE FUNDS AFFECT  
TARGET FIRM PERFORMANCE?

By

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## Abstract

This paper examines the causes and results of shareholder activism by hedge funds over the past twelve years. The overall purpose of the study is to compile financial data to understand if hedge fund activism provides value to the target companies. As shareholder activism in the United States has been an increasing trend, my thesis attempts to explore why hedge funds engage in activism and if this involvement enhances a company's stock price and firm performance. My results showed that there were abnormal stock price returns to the target firms the day after the 13D filing, three days after the filing, and one-month after the filing. Firm performance, as shown through return on equity and return on assets, actually decreased by approximately 50% in both cases one-year after the 13D filing. In conclusion, my analysis shows that in the short-term, value is provided to the stockholders of the target firm. However, long-term it is difficult to determine if shareholder value by hedge fund provides value.

## Part I: Introduction and the Research Question

The overall topic is shareholder activism in the United States and if activists, specifically hedge funds, increase firm performance and/or provide shareholder value for the target firm after engaging in an activist campaign. This thesis will examine the reasons how and why an activist hedge fund gets involved and the outcome of these actions on firm's performance. Firm performance will be measured through several financial metrics, like Return on Assets (ROA) and Return on Equity (ROE) as well as stock prices at various time points. The results will then be used to determine if activism by hedge funds, in the past twelve years, have increased value to the target firm's shareholders.

There has been plenty of work done in this area so far. Most of the past work has centered on all types of shareholder activism, which includes hedge funds, institutional investors (i.e. pension funds, mutual funds), and individual activists. Most recently, scholars have been researching specifically hedge fund activism because of its growing popularity and discussion in the media. For note: an "activist hedge fund is a hedge fund that tries to revoke a certain event in the company it invests in" (Stokman).

"They've [hedge funds] also been busier, launching an average of 240 campaigns in each of the past three years—more than double the number a decade ago. And even though activists are a relatively small group, with only \$75 billion in combined assets under management compared with the \$2.5 trillion hedge-fund industry overall, they've enjoyed a higher rate of asset growth than hedge funds and attracted new partnerships with traditional investors" (McKinsey, 2016)."

In addition to this, since 2007, ~75% of activist campaigns have been started by hedge funds (Goodwin). So hedge fund activism is growing in terms of their AUM as well as the amount of campaigns instigated.

April Kline, Bebchuck, and Bernard Black are some of the premier names that have explored the idea of hedge fund activism and its relation to increased firm performance. These works, and others, are discussed and evaluated in the literature review section of this thesis. The overall consensus is that hedge funds have inherent qualities, such as lock-up periods, lower capital requirements, and less regulation, so they have a greater ability to get involved in aggressive activism – which some argue leads to increased firm performance.

The gap this thesis is attempting to fill is hedge fund activist activity in recent years. Most of the research found focused on activism in the 90's and 2000's, while I want to explore activism in the recent twelve years. I chose twelve years because it will capture not only the financial recession, but also the few years before the recession when the business cycle was extremely good. While this approach will give more recent data, it will also be more difficult to evaluate the “success” of an activist campaign because long-term performance cannot be measured. Success for a hedge fund campaign varies depending on which shareholders' point of view one is examining. The hedge fund activist itself would consider success having their demands met and above normal returns. But regular shareholders would consider success a profitable, smart change to the firm and increased long-term performance and stability. This information is relevant to target corporations, the firms that are worried about an activist campaign being launched on them. It is also relevant to activist investors and regular investors. It is relevant

because this thesis relies on financial data, rather than industry experiences, to understand if performance increases after hedge fund activists engage in activism. This thesis is also important in a legal and government setting. Many policymakers and legal advisors argue that hedge fund activism is actually extremely detrimental to target firms, as hedge funds exploit their influence only to realize short-term gains before exiting the firm (Lipton). Earlier this spring in March, two democratic senators announced a bill “that would take aim at activist hedge funds and their ability to act together in wolf packs to take over public companies” (Moyer). The article states that the time between the 13D filing and the public announcement about the filing, which is currently about ten days, should be limited to two days in order to eliminate insider trading. Mark Lipton is also a famous opponent against shareholder activism. He is one of the founding partners at the law firm, Watchell, Lipton, Rosen & Katz. “There are many instances where Lipton openly criticizes the irresponsible actions that activist hedge funds take on American firms” (Cheung). He basically believes that hedge funds take advantage of American corporations and only seek to increase the short-term performance of their target firms (Cheung). In addition to outspoken opponents are “Vote No” campaigns, where “an investor (or coalition of investors) urges shareholders to withhold their votes from one or more of the board-nominated director candidates” (Cloyd). These are among a large number of issues that public defendants and government agencies have cited about shareholder activism and hedge fund activism explicitly.

The specific question this thesis seeks to answer is whether the largest activist hedge funds who have initiated an activist campaign within the past twelve years have increased firm value and/or performance of the target company.

This past summer I worked at J.P. Morgan in the Regional Investment Banking group in New York City. While my job primarily focused on merger and acquisitions, debt offerings, and equity offerings, we did some work involving shareholder activism. Target firms come to my group needing different types of assistance, sometime preemptive and other times reactionary. Preemptive help means that a firm is aware of its weaknesses and presumes they may be vulnerable to a shareholder activist campaign. Firms who have already been targeted also come to my group, needing help engaging with the activist or fending them off. Speaking to some of my group members, shareholder activism has been on the rise as of late. As activism grows in popularity, managers are taking more proactive steps to safeguard their firms from activists and hostile takeovers.

The thesis, and the topic in general, is important to many different stakeholders. These stakeholders include most importantly, businesses, but also hedge funds and general investors. Businesses include target firms of hedge fund activism but also large, public corporations in general. All corporations can be subject to a hedge fund activist campaign if a shareholder, usually a large one, is unhappy with a part of the business. All managers and those running a company must be aware of the firm's weaknesses and how to best attend to them. If not, they are at risk of becoming a target of activism. Management and the Board must be know the weaknesses and also can set the rules about how easily activist investors can get involved, such as having a poison pill clause in the proxy, staggered boards, etc. Hedge funds would also find this data relevant because it would prove whether activism was financially beneficial to firms or whether they should steer clear of it. General investors would find this information useful because they

are also affected when an activism campaign takes place. Not only would this thesis provide some understanding to activism and why hedge funds specifically engage in it (and how), but also if it is beneficial to the company. General investors are also shareholders, like the hedge funds engaging in the activist campaigns, and they often want change within these firms as well. It is important for general investors or shareholders to understand the impact activists can have on a firm, regardless if it is beneficial or destructive involvement.

This manuscript proceeds as follows. Part II is a literature review, where the most relevant and available literature on this topic will be synthesized and examined. It will also allude to the similarities and differences that researchers and scholars in the field have found, as well as provide a basis for further research. Next, Part III will include a method and results section. This is where the sources and primary data selection is described in detail. A list of nine hedge funds and 29 target companies found through the SEC website and other financial resources will be listed. Also, the effect on financial performance, shown through financial metrics and stock prices, will be contained here as well. Part IV is the discussion section, which contains conclusions and explains why my findings were at times different than what was found in other literature/studies. This section will also detail the limitations of this thesis and future steps that can be taken to further explore this idea. Part V is the implications section that will touch on why this thesis is relevant to non-scholars and any advice given to companies based on the findings in this thesis. Finally, Part VI is the conclusion.



## Part II: Literature Review

The general topic is proactive shareholder activism and if it affects firm performance and/or creates shareholder value; specifically, if hedge funds provide value by increasing firm performance when they engage in different stages of shareholder activism. Shareholder activism is defined as a way that shareholders, or owners of a firm, can influence a corporation's behavior by exercising their rights as owners. This occurs when an owner (which can include a hedge fund, institution, or individual investor) purchases over 5% of a firm's shares in order to "put pressure on the management team" (Margolin). Activism is seen as a relatively "cheap" way to instigate change within an organization, as private equity, which is the full-out purchase of a target firm, is expensive and involves more risk.

The history of shareholder activism began in the 1980's with activist blockholders, usually financial organizations, insurance firms, and pension funds (Randall 2007). Generally, activists demanded asset divestitures and share repurchases, but the market and investors' reactions to this activism were usually inconsequential. In a response to this, companies began changing their corporate governance structures to better protect themselves from activists and hostile takeovers decreased. Since the 80's, "institutional investors, religious organizations, labor unions, mutual funds" (Randall) have gotten involved in activist campaigns. Most data has shown that this involvement has led to lackluster returns, mostly due to regulation and general financial limits and rules on these types of institutions. For example, Randall cited that:

*Mutual funds are constrained by tax laws from taking overly concentrated positions in any one company or group of companies. The Securities and*

*Exchange Commission also limits the types of fees that companies regulated by the Investment Company Act of 1940 may charge. Similarly, regulated funds are subject to restrictions on shorting, borrowing, and investing in illiquid securities.*

However when understanding the history of shareholder activism, it is imperative to understand why hedge funds are different than institutional firms (mutual funds, pension funds, large institutional investors). The SEC describes a hedge fund as a firm that is, “usually identified by four characteristics: (1) they are pooled, privately organized investment vehicles; (2) they are administered by professional investment managers with performance-based compensation and significant investments in the fund; (3) they are not widely available to the public; and (4) they operate outside of securities regulation and registration requirements.” These four reasons can partially explain why hedge fund activism might generate superior returns to institutional activists. In layman’s terms, hedge fund managers’ pay is usually based solely on performance, the firms are less regulated (looser fiduciary standards), there is no requirement on holding diversified portfolios, and hedge funds usually have a lock-up period of its funds and can trade on margin. Now, shareholder activism by hedge funds has become one of the most popular forms of activism (J.P. Morgan), but there has not been conclusive research on the affects of hedge fund activism.

An example of an activist case is as follows. Starboard Value is an activist hedge fund with ~\$5 billion in assets under management (AUM). The firm was founded by Jeff Smith in March of 2011. His firm engages in many activist campaigns, and most notably, a campaign against Darden Restaurants. Darden Restaurants is an American restaurant operator that owns Olive Garden, LongHorn Steakhouse, The Capital Grille, and other

chains like these. Darden's current market capitalization is ~10.7B. On April 22<sup>nd</sup>, 2013, Starboard Value filed a 13D that stated their ownership of Darden Restaurants increased to 5.55%. My database showed that there was a 4.89% abnormal return one day after the filing. On September 11<sup>th</sup>, 2014, Starboard released a 300-page plan to increase Darden's earnings. They condemned Olive Garden and the free unlimited breadsticks as well as the eminent sale of Red Lobster (Starboard believed it was a bad idea to sell the brand). On October 24<sup>th</sup>, 2014 – six short weeks later – Starboard succeeded in replacing all 12 members on Darden's board. Today, revenues have bounced back and the value of Darden's stock has increased ~65% since Starboard's involvement (Wallstreet Journal). While this case clearly shows how influential activists can be in igniting change within a company, it is unclear if the 65% stock outperformance is due solely to Starboard's involvement (as the abnormal returns were statistically insignificant in my study).

The relevant trends within shareholder activism are first and foremost, increasing activist involvement. All types of activists are becoming more actively involved, as 2015 marked the year with the most activist campaigns than ever before. In 2015 alone, there were 94 shareholder activist campaigns made by hedge funds compared to 64 in 2014 and very few in 2005 (Gibson Dunn). "Today, more than 10 activist funds (activist or multi-strategy funds) manage over \$10 billion each, or about as much as the entire asset class 10 years ago for each fund (J.P. Morgan – The Activist Revolution, 2014). Recent trends in the general space are individual activist investors more frequently voicing their concerns. Examples of this are Carl Icahn and Bill Ackman, who are both very vocal about demands for corporations they are invested in. Icahn is the President of Icahn Associates Corp, which is a hedge fund. Icahn took over ImClone Systems and sold the

firm to Eli Lilly and took a profit of \$418 million (Business Insider). Both activists have initiated change within organizations.

The most popular demands by shareholder activists are to: redeem the poison pill, eliminate staggered boards, make shareholder voting confidential, sell the company, split the roles of the CEO and Chairman if it is the same person, restructure, replace the CEO or other management, change the payout levels, alter the capital structure, divest a particular business unit or underperforming asset, and also make the board entirely independent members (Black). Margolin, in his work on hedge fund activism, describes the ways in which hedge funds engage, “participation at the annual general meeting, representation of the company’s board, direct contact with the company’s management (private), take-over attempts, or contact with other existing shareholders.”

To better understand shareholder activism by hedge funds, hedge funds and their general structure must again be examined. Almost every academic source I explored cited the structure of hedge funds as part of the reasons for positive outperformance in activist cases. Christopher Clifford cites in his paper on value creation or destruction that,

*“The unique organizational features and lack of regulation for hedge funds as compared to mutual funds or pension funds make for an interesting laboratory to study shareholder activism. Hedge funds are typically not subject to the ERISA or “prudent man” regulations, nor are they required to maintain high levels of diversification in order to receive preferential tax status like mutual funds. Specifically, hedge funds with longer lock-up and redemption notification periods are more likely to initiate activist campaigns.” (Clifford)*

As explained in the section after shareholder activism history, hedge fund structure is much different than mutual and pension funds. Also, the success that hedge fund activism has seen could be explained “in the fact that their demands are often far more drastic than usual activists, varying from board restructuring to public confrontations like shareholder proposals, lawsuits, and takeover efforts” (Becht et al, 2008). Hedge fund managers do not have diversification requirements, compensation is usually mostly, performance-based, and “they can, as a last resort, simply buy up the targeted firm and through this process obtain changes in governance mechanisms” (Clifford, 2008). In addition, “Hedge funds are almost always organized as limited partnerships or limited liability companies to provide pass-through tax treatment. The fund itself does not pay taxes on investment returns. In the USA, hedge funds usually seek exemptions from a number of SEC regulations [as well]” (Connor and Woo). It should be noted that all sources that cited hedge fund activism as providing shareholder value cite a hedge funds structure as the main reason.

A specific framework is used to analyze the every piece of literature and understand the similarities and differences of opinion. First, the theory or outcome on shareholder activism is identified. Second are gaps or issues that either the author or I found with the work, and in some cases, both. Below outlines these core questions and connects the literature to create an overarching view of hedge fund activism and how it affects firm performance based on the literature. While I examined over 20 pieces of academic literature, I used 12 sources for the basis of the literature review – as they were the most relevant and provided a conclusive “yes” or “no” answer to shareholder activism benefits. The literature is categorized into two categories: first by the authors and

researchers who believe shareholder activism by hedge funds is beneficial, and secondly by those who think it is not beneficial or that the data is inconclusive.

First, the theory or outcome is identified in each of the sources. 10 out of the 12 sources believed that hedge fund activism provided shareholder value. This makes sense because most researchers and scholars in this area have studied the positive effects and have continued engaging in studies on the subject. McKinsey and Company's 2016 article on hedge fund activism found that, "among large companies for which data are available, the median activist campaign reverses a downward trajectory in target-company performance and generates excess shareholder returns that persist for at least 36 months" (McKinsey, 2016). While this article does speak of hedge fund activism positively, they do say that excess shareholder returns last about 36 months – which I consider pretty short-term in the life span of a company. In 2015, Bebchuck found there was "no evidence that activist interventions are followed by short-term gains in performance that come at the expense of long-term performance." Randall found that about two-thirds of activists are successful in their activist attempts and that the market reacts positively to news of an activist campaign. The conclusion that Boyson drew was that, "only "active" vultures (vultures that obtain particularly large stakes, board seats, or become the CEO or Chairman of the Board) improve target performance. This result likely occurs because targets of vultures suffer serious operational problems, so that vultures must get involved in management to substantially improve performance." (Boyson and Mooradian). In addition, Stokman showed in his study that long-term performance is positively affected because "6-month window significant positive abnormal returns were found, indicating that the involvement of a hedge fund activist

created value also on a longer term” (Stokman). The other eight sources also had specific reasons and conclusions explaining why they believe hedge fund activism provided outperformance. Two out of the 12 sources had a theory that shareholder activism by hedge funds produced inconclusive data or actually only provided short-term benefits to the target companies. One of these is Alliare and Dauphin’s paper as a rebuttal to Bebchuck’s thesis. “Bebchuk, Brav and Jiang get carried away and associate hedge fund intervention to the subsequent performance of companies long after the hedge funds have sold their shares” (Alliare and Dauphin). They cite several issues with Bebchuck’s paper, such as sample size, the database, the choosing of hedge funds and cases, and even the statistical analysis. They believe that the data surrounding hedge fund activism is currently inconclusive. Lipton is also an opponent with shareholder activism and will be discussed in detail later in the thesis.

Many core issues are identified within the literature, some by the authors and other issues I discovered myself. The most common issue I identified was the time period from which the data came. Many of the sources created their database from time periods prior to the financial crisis. Since the 2008-2009 Great Recession was a significant event in the financial markets, it is important to recognize the differences in hedge fund activism pre- and post- recession. Bebchuck’s well-known 2015 study disproved the idea that hedge fund activism destroys value over the long-term. However, he received criticism for ignoring actual experiences and well-regarded financial opinions – even though he backed up his theory with qualitative data.

*Lack of long-term declines in performance is sufficient for rejecting the myopic-activists claim, especially when assessing performance using the standard*

*measure of Tobin's Q, that performance is higher three, four, and five years after the year of intervention than at the time of intervention (Bebchuck 2015).*

11 out of the 12 sources I examined relied on qualitative data rather than real-life experiences and expert opinions. While this can be seen as an issue, I believe that data is extremely, if not more, relevant and determinate than subjective opinions. April Klein's 2006 study focused only on stock returns immediately after the 13D announcement and a one-year performance after the filing date, so it did not explore long-term performance. Another issue recognized by Bebchuck and Weisbach is that "they [hedge funds] most commonly contact companies privately, so it is difficult to gauge the magnitude of their intervention using publicly- available data"(Bebchuck and Weisbach, 2009).

The literature review provides several examples of shareholder activism trends as a whole, and more specifically with hedge funds. There are differing opinions on whether activists, and hedge funds, create value through their activist campaigns. The most common theme found is that most researches use the 13D filing with the Securities and Exchange Commission (SEC) to measure returns and outperformance (or underperformance) into the future. Another similarity I found is that hedge fund activists are generally more successful in achieving their goals and increasing shareholder value over the longer term than other activists. Moving forward, the research questions this thesis will attempt to answer are: Do hedge fund activists provide shareholder value when they engage in activist campaigns? Why do they engage? The gaps in the literature are stated throughout the analysis above, but overarching gaps are if hedge fund activist campaigns produce superior firm performance within the last twelve years. Most of the information currently in circulation is outdated.



### Part III: Methods and Results Sections

Archival data collection is used instead of surveys for the research portion of this thesis. Surveys are difficult to collect on this topic because relevant people to this thesis are partners at hedge funds or management of large-cap corporations – and they are not accessible. Most of the data and information of why an activist becomes involved with a target company is confidential and must be discovered through probable reasoning. The archival data instead provides public information about a hedge fund and target firms. This public information is found on the Securities and Exchange Commission (SEC) website. Financial data is also used to understand if firm value increases or is not affected by activism. As a note, Randall’s research paper, “*Hedge Fund Activism, Corporate Governance, and Firm Performance*”, was a helpful guide as to how to create and assemble my database in a clear way.

To create the database of hedge funds, SEC Info Website (a tool used to search Edgar) was used to provide a comprehensive list of all 13D filings from the past five years. There have been 28,133 13D filings in the past five years. Note that this number includes 13D Amendments, and each activist case usually has 30+ amendments to its original filing. From there, the database filtered out banks, insurance firms, individuals, pension funds, mutual funds – anything that was not a hedge fund. The database contained hundreds of activist hedge funds from the past ten years. Next, I searched through all 13D’s from the listed ten hedge funds. Requirements for inclusion included a 13D that stated an active reason for increasing ownership above 5% in the “Purpose of Transaction” clause in the 13D (in opposition to a passive filing, which large institutions and mutual funds have to do frequently) (Randall). Purpose of Transactions relating to

mergers and acquisitions and bankruptcy reorganizations were excluded. Another requirement was that the deal occurred in the past twelve years. This decreased the number of hedge funds significantly.

From there, nine hedge funds were picked based off of certain criteria: that they have an AUM greater than \$1 billion and engaged in at least ten significant activist campaigns in the past ten years, and are domiciled in the United States. Each website of the hedge funds were checked to make sure the firm was in fact a hedge fund.

To determine the activist deals chosen, I again searched through the 13D's, but also The Wallstreet Journal, Bloomberg, and FactSet to determine more information about the deal. These news sources provide more clarity on the reasons the hedge fund engaged in the target company and the events that followed. Three to four deals were picked for each hedge fund, altogether creating a sample size of 29 activist deals. It is important to note that activism does occur without a 13D (or a less than 5% stake in a company). Hedge fund activists have recently been able to incite change within a firm with much smaller stakes. An example of this is Carl Icahn's involvement in Time Warner in 2004, where he had a 2.6% stake, activist campaign. For simplicity, only deals where a 13D was filed are included in the sample group, as it becomes significantly more difficult to locate all hedge fund activism deals without a 13D.

The database also includes the firm name of the target, percentage of shares and dollar amount owned by hedge fund at filing date, excess return once the filing from an activist hedge fund has been made shown through stock prices at different time points, and ROA/ROE in the previous and following years from the 13D filing.

Multiple sources are used to obtain this data. The Securities and Exchange Commissions (SEC) website and also Bloomberg are used to compile the list of 10 activist hedge funds from the last 12 years, or the primary sample selection. Hedge funds are considered “active” if they file a Schedule 13D. A Schedule 13D is a form that must be filed with the SEC when ownership exceeds 5% of any class of a company’s shares. This information must be disclosed within ten days of the trade being placed (Kline). A 13D usually includes whether this action is “active” or “passive.” The list of hedge funds is found through searching “hedge funds and activism,” “hedge funds and activist campaigns,” and “hedge funds and 13D” (Clifford). Hedge fund activists who filed a 13D but stated the reason as “unwilling to give up the option of affecting the firm” or gave passive reasons as to why their ownership has increased above 5% are not included in my list. These hedge funds declare themselves as “passive owners” and therefore, cannot involve themselves in activist campaigns. This compiled list is then verified through the firm’s websites in order to confirm that the firms are indeed a hedge fund.

<b>Hedge Fund Name</b>	<b>CEO</b>	<b>Notes</b>
<b>Blue Harbour Group</b>	Clifton Robbins	“Friendly Activist”
<b>MHR Fund Management</b>	Mark Rachesky	Aggressive; worked for Icahn
<b>Starboard Value</b>	Jeffrey Smith	Takedown of Darden
<b>Sachem Head Capital Mgmt.</b>	Scott Ferguson	Worked for Ackman
<b>Triam Fund Management</b>	Nelson Peltz	Peter May and Ed Gordon
<b>Cevian Capital (Europe)</b>	Christer Gardell	Firm backed by Carl Icahn
<b>Pershing Square Capital Mgmt.</b>	Bill Ackman	Large, concentrated bets
<b>ValueAct Capital Partners</b>	Jeff Ubben	Long-term focus
<b>Third Point Partners</b>	Daniel Loeb	Moving towards more short-term
<b>Icahn Enterprises</b>	Carl Icahn	Most well-known

Number	Activist Hedge Fund	Target Firm Name	Ticker	13D Filing Date
1	Blue Harbour Group	Allscripts	MDRX	10/10/14
		CSK Auto Corp.	CAO	1/17/06
		Chicos	CHS	9/9/13
2	MHR Fund Management	Lionsgate	LGF/A	8/1/05
		Loral Space & Communications	LORL	11/30/05
		Titan International	TWI	1/21/14
3	Starboard Value	Darden Restaurants	DRI	12/23/13
		Office Depot	ODP	9/5/12
		Brink's Home Security	BCO	4/22/15
		Staples	SPLS	12/10/14
4	Sachem Head Capital Mgmt.	CDK Global	CDK	10/20/14
		Zoetis	ZTS	11/3/14
		Autodesk	ADSK	11/2/15
5	Triam Fund Management	Snapple (owned by Dr. Pepper)	DPS	12/9/08
		Tiffany's	TIF	2/21/07
6	Pershing Square Capital Mgmt.	Wendy's	WEN	4/26/05
		JCPenny	JCP	10/8/10
		Valeant	VRX	3/17/15
7	ValueAct Capital Partners	Adobe Systems	ADBE	11/27/10
		Microsoft	MSFT	4/22/13
		Halliburton/Baker Hughes	BHI	1/15/15
8	Third Point Partners	Sony	SNE	5/14/13
		Yahoo	YHOO	9/9/11
		Sothebys	BID	8/15/13
9	Icahn Enterprises	Apple, Inc.	AAPL	8/13/13
		Chesapeake	CHK	12/17/10
		AIG	AIG	10/28/15
		CVR Energy	CVI	1/25/13
		Hertz Global	HTZ	7/11/16

Bloomberg and the Center for Research in Security Prices (CRSP) databases provide the primary financial data on 29 target companies that have been targeted by the above list of hedge funds in the past. Bloomberg provided the stock prices in both the short-term and over a long-term period of 24 months as well as three years, excess return values with comparison to a benchmark, and also financial metrics such as ROA, ROE, and operational profitability of these target firms. Factset and Thompson Reuters, which are highly acknowledged financial resources, were also used as checks to this financial data.

The hypothesis: hedge fund activists do provide a certain level of increased value to the target firm. Even if management does not adhere to the hedge fund's specific requests, there is positive change within the company and ultimately for the shareholders.

This section will detail the results from the financial database. Results were found by comparing financial data pre- and post- 13D filing and stock returns versus the S&P.

Abnormal stock returns were calculated over six time periods versus the S&P 500 benchmark. The abnormal returns were calculated by taking the returns of the target firm at different stock prices subtracted by returns of the S&P 500 at different prices. I then compiled an average from all 30 companies to determine the average abnormal return.

The abnormal returns are shown below:

- Day of Filing: 2.49%
- One Day After Filing: 3.67%
- One Month After Filing: 7.20%
- Six Months After Filing: 7.79%
- One Year After Filing: 0.44%
- Two Years After Filing: 15.92%

A T-test was done to determine if the mean is statistically significant from zero. If true, it is highly likely the effect on stock returns is positive on filing day. The data was statistically significant at greater than 0 in three cases: day of filing, one day after filing, and one-month after filing. The later three time periods, six months after, one year after, and two years after, were deemed statistically insignificant.

In terms of financial performance, return on equity and return on assets were used. I looked at the ROE and ROA previous to filing (the last quarterly report filed before the 13D filing) and compared the figure to one-year after the 13D filing. The results are as follows:

- ROE Change One Year After 13D Filing: -51.60%
- ROA Change One Year After 13D Filing: -59.68%

ROE and ROA decreased by over 50% in both financial metrics one year after the 13D filing. A T-test was not done to determine if the mean was statistically significant.

#### Part IV: Discussion Section

There were several conclusions that were drawn from the methods section. The first conclusion is that stock price abnormal returns past one-month after the 13D filing date are statistically insignificant because of how much goes into a stock price. It is extremely difficult to determine if the hedge fund activism is providing the increased stock prices – or if it is the many other factors that can affect a stock: macroeconomic trends, management changes, industry trends, domestic economic factors, and other tailwinds and headwinds. This could explain why the abnormal returns past one month after filing are deemed statistically insignificant. Some scholars and researches have come to this same conclusion. Another conclusion I discovered I am unsure about. Perhaps, hedge fund activism only affects target firm performance (stock prices) in the short-term. And in the long-term it does not affect target firm's stock prices or affects it in a negative way. This conclusion leads to the question: is hedge fund activism only beneficial in the short-term? While my data adds value to this claim, my personal opinion is that this conclusion is not so black and white. It is extremely difficult to determine if hedge fund involvement solely provides long-term value because of the many other factors on a firm's stock price (macroeconomic, domestic affairs, industry trends). This does not prove, however, that hedge fund activism is detrimental to shareholder value and a target firm in the long-term.

My conclusion surrounding the financial metrics is slightly less clear. ROE and ROA decreased by 51% and 59% respectively one year after the 13D filing. This is not consistent with the claim that hedge fund activism provides value to target firms. When I began this thesis, I believed that these financial metrics would be drastically improved

once an activist got involved. However, there is a reason that might account for these anomalies. I looked at ROE and ROA one year after the 13D filing, which is a relatively short period of time. Financial metrics, unlike stock price, are only publically announced four times a year at the quarterly reports. Stock prices reflect immediate changes, as they are priced in immediately after the news or sometimes even before. Financial metrics are the actual operations of the company, and they take much longer to change. Even if an activist gets involved, it often takes longer than a few months or a year for the changes made to show up on the financial statements. It is also important to note that Klein's 2006 study produced very similar results: "we show that EPS, return on assets (ROA), and return on equity (ROE) decline one year after the 13D filing, and that cash flows from operations remain stable" (Klein, 2006). Further expanding on my thesis, I would look at ROE and ROA metrics two to three years after the 13D filing instead of just one year. This could possibly allow for more time for the changes to materialize in the financial statements and metrics.

The limitations of this thesis must be recognized. Some limitations and shortcomings are the sample size, the list of hedge funds chosen, the time frame, the outside factors on a company's performance, ignoring competitors' returns over the given time period. First, the sample size is considered small in terms of statistical data. Ten hedge funds were chosen and then 2-4 of their activist campaigns were measured. In total, only 29 activist campaigns are used to determine if hedge fund activism is "successful," when in actuality, a much larger sample size must be used when determining success or failure. Secondly, the list of hedge funds used is somewhat skewed. These activist hedge funds were chosen because they had been extremely active

in the shareholder activism space in the last 10 years and they were the largest firms engaged in activism. Because these firms are the largest, still in business, and presumably some of the best hedge funds in the country or world – it is presenting a biased sample group of hedge funds. To further extend this thesis and better represent hedge fund activism, a more holistic group of hedge funds (small, large, active, somewhat inactive, or those which have closed and presume to have gone out of business) must be encompassed in the sample group. Another shortcoming in this thesis is the time frame used. Because more recent data (twelve years or less) was used, returns, operational performance, and success of an activist campaign are determined from a somewhat short-term standpoint. When in reality, long-term performance, stability, and growth are necessary in determining an activist campaign's success. In my opinion, while short-term performance is important for stock price and compensation reasons, long-term performance shows the viability, adaptability, and success of a firm. Lastly, I did not look at competitors' performance in comparison to the target firms. This would simply provide another benchmark, besides the S&P 500 Index that was used, to determine excess returns.

Outside factors on a company's performance, such as macroeconomic factors, industry trends, company specific issues, are all difficult to quantify. Firm performance is not solely affected by activism intervention, and this is why a T-test was done to determine how statistically significant my findings were. After six-months, the data was statistically insignificant, most likely due to all the other outside factors that could affect firm performance.



Another limitation includes the merger and acquisition aspect of hedge fund activism. Many hedge fund activists push for a sale of a company or a merger. When this happens, financial data for the original company becomes more difficult to find or sometimes completely unavailable. This occurred with several of the original target companies that were included in the database. For example, Kraft was a target of the hedge fund activist firm, Third Point Partners back in 2011. They pushed for a sale, which eventually happened. In 2015, Heinz and Kraft merged under the ownership of Berkshire Hathaway and 3G. Now, information on the original Kraft company is not available/easy to access. Thus, Kraft was excluded from the database. Therefore, it is difficult to see if hedge fund activism involving a sale of a company is beneficial or not. Similar to this, hedge fund activists often times take a company from public to private (in a private equity buyout, or an LBO). When this happens, the data available for the company is also no longer public information.

Further, the database used for this thesis only included activist targets where a 13D was filed. In many cases, hedge funds can enact change within a company with less than a 5% stake, often times even a ~1% stake.

There are several future studies I have identified. First, any of my limitations could be adapted in a further study. Expanding off of this, further studies could be in a particular industry or space. This would be interesting because it seems that there are certain industries and/or companies that are targeted by activists. For example, one could measure if hedge fund activism in the healthcare or technology space were more successful or provided increased shareholder value over hedge fund activism in other spaces. Another future study could be to look at shareholder activism by hedge funds of

all sizes. For this thesis, I chose to focus on the largest hedge fund activists. However, I could take the list of all hedge funds and split it into two groups: large activist hedge funds and small activist hedge funds. Then, one could look at activism success between the two groups. This would attempt to answer the hypothesis that hedge fund activism by large hedge funds, because of their powerful CEOs and dollar amount invested, are successful. Going even further, it would be interesting to explore the affects on firm performance after demands by hedge fund activists were either demanded or brought to fruition. For example, when an activist successfully replaces the Board of a company – what are the affects on firm performance?

There are many more future studies that could be performed to better explain if hedge fund activism provides value to target firms.

## Part V: Implications Section

This thesis is not only relevant for academics but non-academics as well. Hedge funds and target company's management would obviously consider this thesis relevant, as they are the two main stakeholders. However, as stated previously, all shareholders should be aware of both hedge fund activists' influence and ability to enact change. Employees of large, public companies should understand hedge fund activism and the effect it can have on their firm and their jobs. If a hedge fund activist forces an acquisition between two companies, there is a chance that employees of the firm being acquired could lose their jobs during the acquisition process. Or, if an underperforming company is targeted, they could be forced to lay off a division and its employees at the demand of the hedge fund activist. The question posed can aid all of the applicable stakeholders because it can provide valuable insight into why hedge funds get involved and what often happens when they do.

There is advice I can give for companies, both the activist hedge funds and target companies, based on my findings. For activist hedge funds, my findings bring up the question if activism is really only beneficial in the short-term. Because only day of filing, one day after filing, and one month after filing were statistically significant, it is possible only short-term benefits are provided. And after one month of the filing, either it is too difficult to determine hedge fund activists' effect on a stock or there is value being lost over the long-term because of intervention. Before a hedge fund engages in activism, they should understand if their proposed changes will provide short-term or long-term value: are their actions only short-term focused (in order to bump the stock price) or can they actually provide meaningful, long-term value to the target company.

My advice for the target companies, or those companies who have an activist hedge fund campaign launched on them, is to understand their own weaknesses and the activists' motives. First, understanding your firm's weaknesses is key to knowing if an activist will get involved in your company and what they will attempt to target. My findings show that any sized company can be targeted. Even Apple, one of the largest and most profitable companies arguably in the world, has been targeted by shareholder activists. Most of the companies in my database are large-cap, Fortune 500 stocks. Secondly, it is imperative to understand the activists' motives. If they are long-term focused, perhaps activism could not be such a negative event? Maybe it could unlock shareholder value.

## Part VI: Conclusion

In conclusion, this thesis was done to shed more light on shareholder activism by hedge funds in the past twelve years in the United States. There has been plenty of research on shareholder activism by institutions, and most have led to the conclusion that institutional activism is not beneficial for the target company (Klein, Bebchuck). However, more recently hedge fund activism has grown in frequency and consequently, so has the amount of research and knowledge about it (McKinsey, 2016). In addition to this, Lipton and other scholars, lawyers, regulators have been adamantly and publically opposed to shareholder activism.

The reasons and ways that hedge funds get involved were explored. Hedge funds' have a structure that is conducive to activism, as opposed to more tightly regulated mutual funds, pension funds, and other institutional firms.

Firm performance was measured through several financial metrics, like Return on Assets (ROA) and Return on Equity (ROE) as well as stock prices at various points. I used the average of the abnormal returns at each different stock price over the S&P 500. The abnormal returns for day of the filing, day after the filing, and one-month after the filing were all deemed statistically significant. This shows that there is short-term outperformance involved with an activist campaign. However, six-months, one-year, and two-years after the filing abnormal returns were deemed statistically insignificant. These results pose the question: is shareholder activism by hedge funds only beneficial in the short-term? Because there are too many factors affecting stock prices over the long-term, it is difficult to determine if hedge fund activism is the main cause in this outperformance. ROA and ROE declined significantly one year after the filing. These

results did not agree with the general consensus in the literature. I attribute this anomaly to the time period – financial metrics of a firm are reported infrequently and are less up-to-date/preemptive than stock prices. If I were to expand on this study and better measure ROE and ROA, I would look two, three, or five years after the filing. Several other further studies and gaps were identified as well.

Throughout this thesis, I have explored the nature of activism and its history, the structure of hedge fund's and why they engage in activism, and also different cases of hedge fund activism and its affect on target firm performance.

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