Harvard Study: Boards, Not Shareholders, Are Short-Term Thinkers

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The long-held view that insulating corporate boards from shareholders protects against short-termism is nonsense, according to a study out of Harvard's law school.

(April 17, 2013) - The Chinese Wall between boards and shareholders that some corporations believe leads to long-term value serves the opposite end, according to a paper.

Lucian Bebchuk, the director of Harvard Law School's corporate governance program, has published an exhaustive study and literature review on the argument for board insulation. His conclusion: it's utter baloney.

"In contrast to what insulation advocates commonly assume, short investment horizons and imperfect market pricing do not imply that board insulation will be value-increasing in the long term," Bebchuk wrote. "Shareholder activism, and the fear of shareholder intervention, will produce not only long-term costs but also some significant countervailing long-term benefits."

Bebchuk cited a number of studies indicating that markets react positively to shows of shareholder activism. That is, meddlesome investors prove beneficial for the value of a certain security, according to empirical evidence, and not the reverse as some corporations claim.

One 2008 study of more than 1,000 activist interventions between 2001 and 2006 showed an average abnormal stock return of 7% to 8% during the 40-day announcement window. Another major study focused on activist campaigns by hedge funds, which resulted in average additional gains of 10%.

Supporters of isolated corporate boards would argue that these gains do not reflect long-term growth, but support their claims of shareholder short-termism. In response, Bebchuk and two colleagues undertook an empirical study of activist campaigns in the long term, and found no evidence that abnormal returns reverse over five years following the activity.

He concluded with a call for (more) action: "Policy makers and institutional investors should, going forward, reject the arguments for limited shareholder rights and involvement regularly made in the name of long-term value."

Read the entire study, "The Myth That Insulating Boards Serves Long-Term Value," here. It will be published in a forthcoming issue of the *Harvard Law Review*.