Study Says Activist Investors Good For Long Term

ValueWalk
By Mark Melin
August 21, 2014

Researchers studied three years before and five years after activist interventions and discovered positive long term results

Critics have charged that the practice of activist hedge fund investors generates short term gains for activists but weakens the companies in the long run. This isn't true, according to a new academic study titled "The Long Term Effects of Hedge Fund Activism."

Harvard University's Lucian Bebchuk, Duke University's Alon Brav and Columbia University's Wei Jiang examined activist targets from 1994 to 2007, monitoring the stock price of activist target stocks against a benchmark index three years before and five years after the target intervention month.

In almost all cases, the activist intervention improved long term stock performance.

Activist investors target underperforming companies

The study notes that activists almost exclusively target underperforming companies. This turns around after the activist intervention, as the stock's traditional lag behind the stock index benchmark reverses – and not just in the short term.

Five years following the activist intervention, the study noted operating performance relative to peers "improves consistently." Companies targeted by activists, on average, close two-thirds of their gap with peers in terms of return-on-assets. Further, two-fifths of the peer gap in how companies turn book value into shareholder wealth was closed, Harvard's Bebchuk noted in a Wall Street Journal opinion piece on the topic.

The study supported common suspicions that after activist's intentions are public the stock price spikes, which was confirmed as an average 6 percent immediate rise after the intervention took place. Critics have charged this price gain is short lived, but the study finds otherwise. "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," Bebchuk wrote.

Activist investors' pump-and-dump schemes

Another significant charge made by critics is the "pump-and-dump" claim that activists bail out of the stock just after they achieve their short term objectives, leaving long term investors in the lurch with an underperforming stock. This claim is also debunked. Studying the three-year period after activist's sold their exposure to a point below the 5% disclosure threshold, the authors noted that the stock did not experience negative abnormal stock returns during this period.

A significant concern regarding activist takeovers is the increased debt and leverage that results from activities such as pumping up shareholder dividends and engaging in stock buybacks. Another concern is the resulting reduction in capital expenditures that often results from an activist takeover. The report notes, however, activist interventions are followed by significant improvements in operating performance.