Lipton Takes on Bebchuk over Shareholder Activism

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By Gregory J. Millman
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Earlier this year, Martin Lipton, a founding partner of law firm Wachtell Lipton Rozen & Katz, and inventor of the poison pill, threw down a gauntlet to shareholder rights advocate Lucian Bebchuk, professor of law, economics and finance at Harvard Law School and director of its corporate governance program. The challenge: prove that shareholder activism has long-term benefits.

Experts who spoke with Risk & Compliance Journal say that Bebchuk met the challenge, in a paper published in July. Professor Bebchuk helpfully summarized his findings in an August op-ed in the Wall Street Journal.

He and his co-authors examined about 2,000 activist interventions over the period 1994-2007. They found higher stock returns and better operating performance over a five-year horizon as measured by return on assets and Tobin's Q, the ratio between the market value of an asset and its replacement value, for which analysts often use the market capitalization and the book value, respectively. If the Tobin's Q is higher than 1, it means, loosely, that the stock market values the company at more than book, and therefore that management is adding something.

"The evidence is strongly against Marty [Lipton] and that's the story," said Steven Kaplan, a finance professor at the University of Chicago's Booth School of Business.

For boards, managers and regulators, this means simply that the oft-heard argument that shareholder activism leads companies to focus on short-term results at the expense of long-term investments, and thereby to do more harm than good, is unsupported. It may not be wrong, but adherents have produced no empirical evidence to prove it's right. In fact, the available empirical evidence decisively favors the activists.

The logical question then, is obvious. If shareholder activism is a good thing, should regulations and company policies put obstacles in the way of shareholder activists?

Mr. Lipton, famed for his ingenuity in championing management against activists, didn't run up the white flag. He responded to the study with a memo that attacked on two fronts.

First, Mr. Lipton disputed the value of Tobin's Q.

Second, he disputed the value of empirical evidence itself, in favor of "anecdotal evidence and depth of real-world experience."

Although they acknowledged that Tobin's Q is a somewhat controversial metric for several reasons, finance and governance experts who spoke with Risk & Compliance Journal were unimpressed by the Lipton case.

“Tobin’s Q is a red herring,” said Professor Kaplan, “But ROA is a good measure and stock return is a good measure and there’s no evidence they go down, so the claim that the activists on average are harmful is not in the data. It‘s not defensible.”

Jeffrey N. Gordon, co-director, Ira M. Millstein Center for Global Markets and Corporate Ownership at Columbia University, called Lipton’s criticisms of Tobin’s Q “a magician’s effort to divert the audience’s attention from what is going on”, explaining that, “The favorable ROA results show that these firms under the influence of the activists are performing better.”

About the value of anecdotal evidence and experience, Professor Gordon said, “You wouldn’t accept a doctor’s anecdotal evidence over well-controlled studies of whether or not a treatment is going to work. Why shouldn’t we bring the same degree of rigor to this this phenomenon?”

Yet both Professors Kaplan and Gordon pointed to the recent examples of J.C. Penney as a case where activism didn’t work. “The fact is that activists are not right 100% of the time. To get good returns you just need to be right more than half the time,” explained Professor Kaplan.

The evidence says that activists are clearing that bar.

Wachtell Lipton didn’t respond to requests for comment.