The Morning Risk Report: Apple, Icahn, Gross, and Mother Teresa

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Last week, activist investor Carl Icahn sent a letter to Apple CEO Tim Cook, urging Apple to boost its buyback from a mere $60 billion to $150 billion. What interests us is the reaction of Pimco fund manager Bill Gross, who tweeted, "Icahn should leave #Apple alone & spend more time like Bill Gates. If #Icahn's so smart, use it to help people not yourself." Leave aside the incongruity of invoking the name of Mr. Gates to defend Apple.

To our knowledge, no one has ever mistaken Carl Icahn for Mother Teresa. Yet as Adam Smith wrote, "It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest." If as Mr. Gross suggests, Mr. Icahn is intent on helping himself, it's only fair to point out that his regard to his own self-interest has often helped other shareholders dine well. In a 2010 paper entitled "Is Carl Icahn Good for Long-Term Shareholders: A Case Study in Shareholder Activism" researchers found positive stock price moves on announcement of Mr. Icahn's taking a position in a firm, and attributed the difference in performance between firms he subsequently acquired or took private and firms that remained independent to the fact that the latter were able to resist his recommendations. This is consistent with research we spotlighted last month in which Harvard Law School professor Lucian Bebchuk found long term stock price and operating performance improvements in companies targeted by activists.

To the extent that long-term value creation for shareholders helps all stakeholders in the economy, pressure from Mr. Icahn and his activist ilk on Apple and similar companies to pay out their cash hoards may even be in the national interest. Professor Jay Ritter of the University of Florida has demonstrated the perils of investing in high-growth economies, finding an inverse correlation between economic growth and shareholder returns. In too many cases, companies in high-growth economies hold onto or mis-invest their cash, instead of returning it to shareholders who can make better choices about where the funds are best deployed. Ritter wrote, "the key to adding value is investing operating cash flow in all available positive-NPV [net present value] projects, while at the same time returning any excess cash and capital to investors through dividends and stock repurchases." That seems to be what Mr. Icahn is pressuring Apple to do. The more efforts to exert such pressure succeed, the likelier paying out excess cash will become the norm, and to the extent that value creation helps other people besides the activists themselves, Mr. Gross should have nothing to cavil at.