STANDING ON THE SHOULDERS OF GIANTS: THE EFFECT OF PASSIVE INVESTORS ON ACTIVISM

Discussion

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What the paper does

— Analyze the effect that passive investors have on shareholder activism
— Specifically, how activist campaigns and their tactics depend on the presence (and implied support) of passive investors (index funds)
— Data: 1) US index fund portfolio holdings, 2) US activist campaigns
— Identification strategy – use Russell 1,000/2,000 index cutoff to exogenously determine aggregate stake that passive investors hold in firm x
— Presence of passive investors
  • Unrelated to likelihood that firm is targeted by activists
  • Positive related to Likelihood that activist campaign features score relatively high on “aggressiveness” scale; relationship likely causal
— Conclusion: Passive investors appear to mitigate free-rider problems, help activists execute successful engagements
Findings and contribution

— Paper fits nicely into fast-growing literature on interaction between passive and active investors
— Economic magnitudes are impressive
— Identification strategy is credible
— Clear potential to make significant contribution
— I very much like the paper
— Consider including it in your PhD course syllabi
Issues worthwhile exploring more:

Are these effects permanent or transient?

Appel Gormley Keim 2016 JFE

“We find no evidence, however, that greater ownership by passive mutual funds is associated with more activism by non-passive institutions; instead, we find evidence of less activism by non-passive institutions, consistent with passive investors monitoring managers and reducing the need for activism by other investors […] This magnitude is large given that a firm’s likelihood of an activism event in a given year in our sample is, on average, only 1.6%.”

Appel Gormley Keim 2017 (this paper)

“We find that the estimated effect of passive ownership on the likelihood of activism is statistically indistinguishable from zero. […] These estimates differ slightly from those found in AGK who document a similarly small, but statistically significant [negative effect].”

Q: Will we find the paper’s main effect if we re-visit the data in x years?

<table>
<thead>
<tr>
<th>Dependent variable</th>
<th>Indicator for hedge fund activism event</th>
</tr>
</thead>
<tbody>
<tr>
<td>Passive %</td>
<td>-0.131* (0.0721)</td>
</tr>
<tr>
<td></td>
<td>-0.130* (0.0718)</td>
</tr>
<tr>
<td></td>
<td>-0.162** (0.0805)</td>
</tr>
<tr>
<td>Bandwidth</td>
<td>250</td>
</tr>
<tr>
<td>Polynomial order, N</td>
<td>1</td>
</tr>
<tr>
<td>Float control</td>
<td>Yes</td>
</tr>
<tr>
<td>Year fixed effects</td>
<td>Yes</td>
</tr>
<tr>
<td># of firms</td>
<td>1,654</td>
</tr>
<tr>
<td>Observations</td>
<td>4,415</td>
</tr>
</tbody>
</table>
Comment 2: Implication is that rising passive ownership contributes to increasingly hostile activist campaigns

—Seems possible but unlikely

“While there has been a long tradition of extensive shareholder engagement behind closed doors in the U.K., we have recently witnessed increasing willingness of U.K. institutional shareholders to seek a public forum for the right cause,” he says, adding that the shift goes both ways: “If you look at the U.S., there is a trend away from a focus on proxy contests towards European-style settlements behind closed doors.”

David Trenchard, formerly Knight Vinke

—What about markets where proxy fights are not the way to win?
  • A paper I know well: Becht, Franks, Grant, Wagner (2017) RFS
What role do passive investors play outside the US? And – is the activist business model converging globally?

— Italy – most activist engagements in relative terms after US, but activism does not involve proxy fights

— Japan – most activist engagements in absolute terms after US, but US-style activism has mostly failed

### Activist engagements relative to market size and takeovers

<table>
<thead>
<tr>
<th>Region/Country</th>
<th>/Total number of activist engagements</th>
<th>/Activist engagements per 1,000 listed firms</th>
<th>/Unsolicited bids per 1,000 listed firms</th>
<th>/Activist engagements per year (avg)</th>
<th>/Unsolicited bids per year (avg)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Region</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Asia</td>
<td>214</td>
<td>3.2</td>
<td>0.5</td>
<td>19.5</td>
<td>2.8</td>
</tr>
<tr>
<td>Europe</td>
<td>381</td>
<td>3.4</td>
<td>2.1</td>
<td>34.6</td>
<td>20.5</td>
</tr>
<tr>
<td>North America</td>
<td>1,145</td>
<td>11.7</td>
<td>4.6</td>
<td>104.1</td>
<td>40.1</td>
</tr>
</tbody>
</table>

Countries with at least five activist engagements during sample period

- U.S. 1,125
- Italy 42
- Luxembourg 5
- Netherlands 22
- Germany 53
- Switzerland 19
- U.K. 165
- Japan 184
- Sweden 15
Comment 3 – Wolf Packs

— Much recent attention, including SEC in 2015, on wolf packs
  • activist engagements involving multiple funds for the same target firm
  • observable and hidden types
— We see higher success rates (outcomes, performance) for wolf pack activism.
— But causality is hard to establish
  • Do we see higher success rates for wolf pack engagements because hedge funds coordinate and hunt as a pack..?
  • ...or do we see multiple funds in the same engagement but without coordination, rather like “if you go to a Grateful Dead concert, you’re going to find a lot of Grateful Dead fans” (Phil Goldstein, Bulldog Investor, one of the targets of the SEC’s 2015 inquiries)
Comment 4 – What do we gain from IV?

Is it worth it?
Could you show direct, uninstrumented, estimation?
— Coefficients are the same? Different?
— IF SAME: I would be curious what effect of other shareholders is (active funds, hedge funds)
— IF DIFFERENT: Coefficient differences? Why? Is IV estimate potentially biased?
  • Please read Wei Jiang’s 2017 RCF (polite) summary of IV estimates
Other comments

— Number of board seats sought – scale by board size?
— Table 7 – passive investors lead to higher probability of activist settling (which paper refers to as a success)
  • But no increase in «activist wins» and no decrease in «firm wins»
  • Why not? I am puzzled. Settlements may be okay but activists want to win
Conclusion

— Interesting question
— Excellent execution and tight paper
— Novel and interesting empirical findings
— I greatly enjoyed reading the paper