

Discussion of

Coffee Jr, John C., Robert J. Jackson Jr, Joshua R. Mitts, and Robert E. Bishop. "*Activist Directors and Agency Costs: What Happens When an Activist Director Goes on the Board.*" *Cornell L. Rev.* 104 (2018): 381.

IESE Barcelona, 25 October 2019

Marco Becht

Structure

- Activist Settlements and Director Appointments
 - Process and facts
- What happens when hedge fund directors are appointed to the board?
 - Event study based on 8K filings (“ad hoc” disclosures)
 - Difference-in-Differences analysis
 - Evidence that information in 8Ks “leaks” before disclosure (insider trading)
- Interpretation
 - Who leaks and how?
- Policy implications
 - Based on general view about activist settlements
 - Based on insider trading evidence

Activist Settlements: Empirics

Interesting stylised facts from database of 475 settlements.

Stylised facts undisputed and consistent with

Bebchuk, Lucian A. and Brav, Alon and Jiang, Wei and Keusch, Thomas, Dancing with Activists (June 1, 2017). European Corporate Governance Institute (ECGI) - Finance Working Paper No. 604/2019 [Last revised: 16 Jun 2019]

Table 5. The Content of Settlement Agreements

This table outlines the terms specified in settlement agreements between activist hedge funds and their target companies. Panel A tabulates the number of settlement agreements that specify board changes or direct actions. Panel B provides descriptive statistics on individual settlement terms. The frequencies represent the number and percentage of settlement agreements that led to a certain outcome. The averages represent the average number of director additions or departures per settlement. Panel C compares the number of director departures to the number of director additions. ***, **, and * denote statistical significance at the 1%, 5%, and 10% level, respectively (two-tailed).

<i>Panel A. Proxies for Board Turnover and Direct Actions</i>			
	# Settlements	% Settlements	
Director Turnover	342	85.71	
Sale Merger Asset Sale CEO Departure	33	8.27	
Director Turnover Only	319	79.95	
Sale Merger Asset Sale CEO Departure Only	10	2.51	
Director Turnover & Sale Merger Asset Sale CEO Departure	352	88.22	
<i>Panel B. Individual Settlement Terms</i>			
	# Settlements	% Settlements	Average
Addition of New Director(s)	335	83.96	1.79
Addition of Director(s) Affiliated with Activist	207	51.88	0.65
Addition of Director(s) Favored by but Unaffiliated with Activist	209	52.38	0.94
Addition of other Director(s)	57	14.29	0.22
Director Departure(s)	150	37.59	0.87
CEO Departure	21	5.26	-
Sale or Merger of Target Firm	10	2.51	-
Sale of a Part of the Firm's Assets	2	0.50	-
Formation of Strategic Transactions Committee	23	5.76	-
Exploration of Strategic Alternatives w/o Committee	19	4.76	-
Buyback Program Related Announcement	21	5.26	-

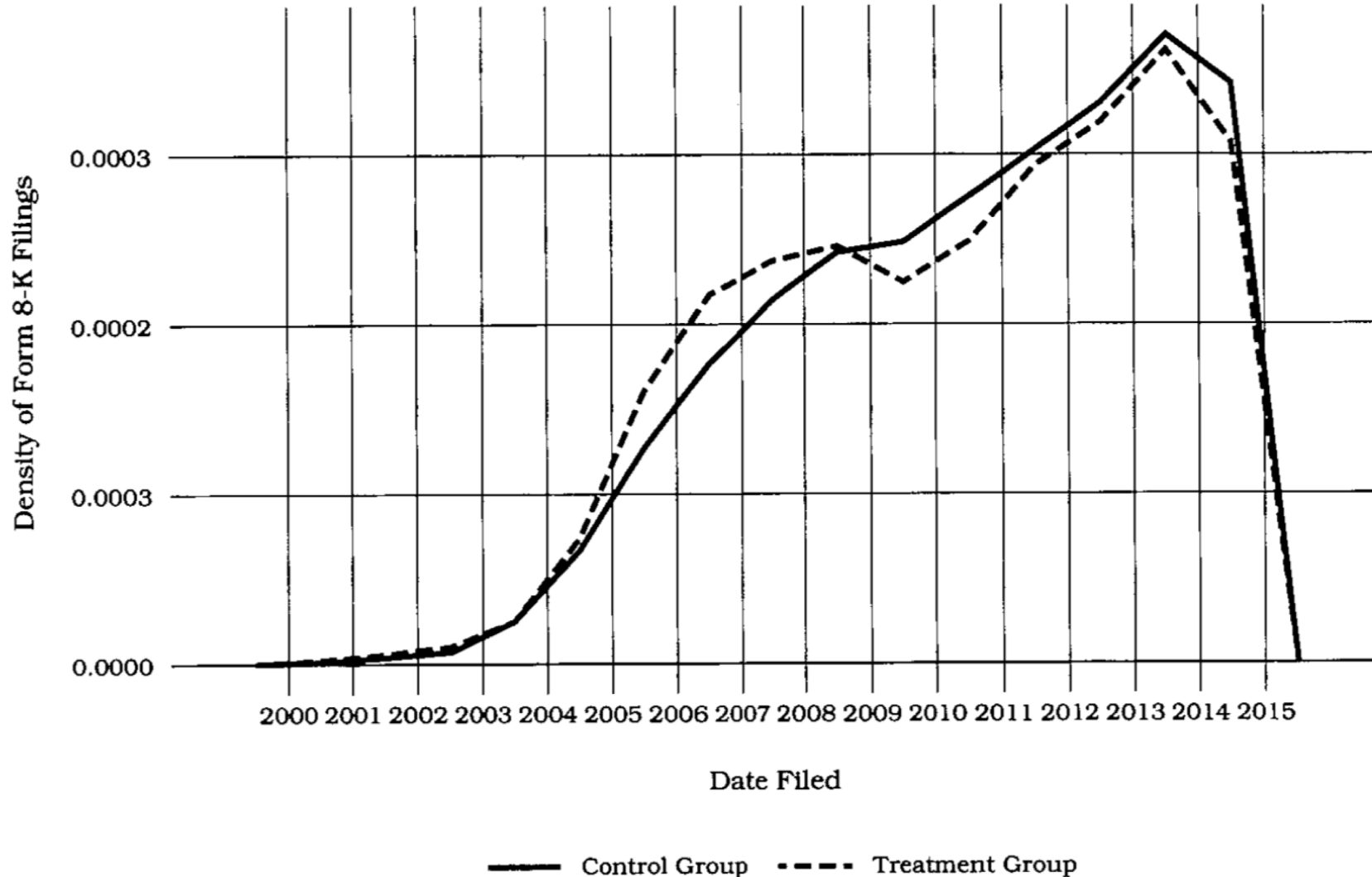
Activist Settlements: In Principle

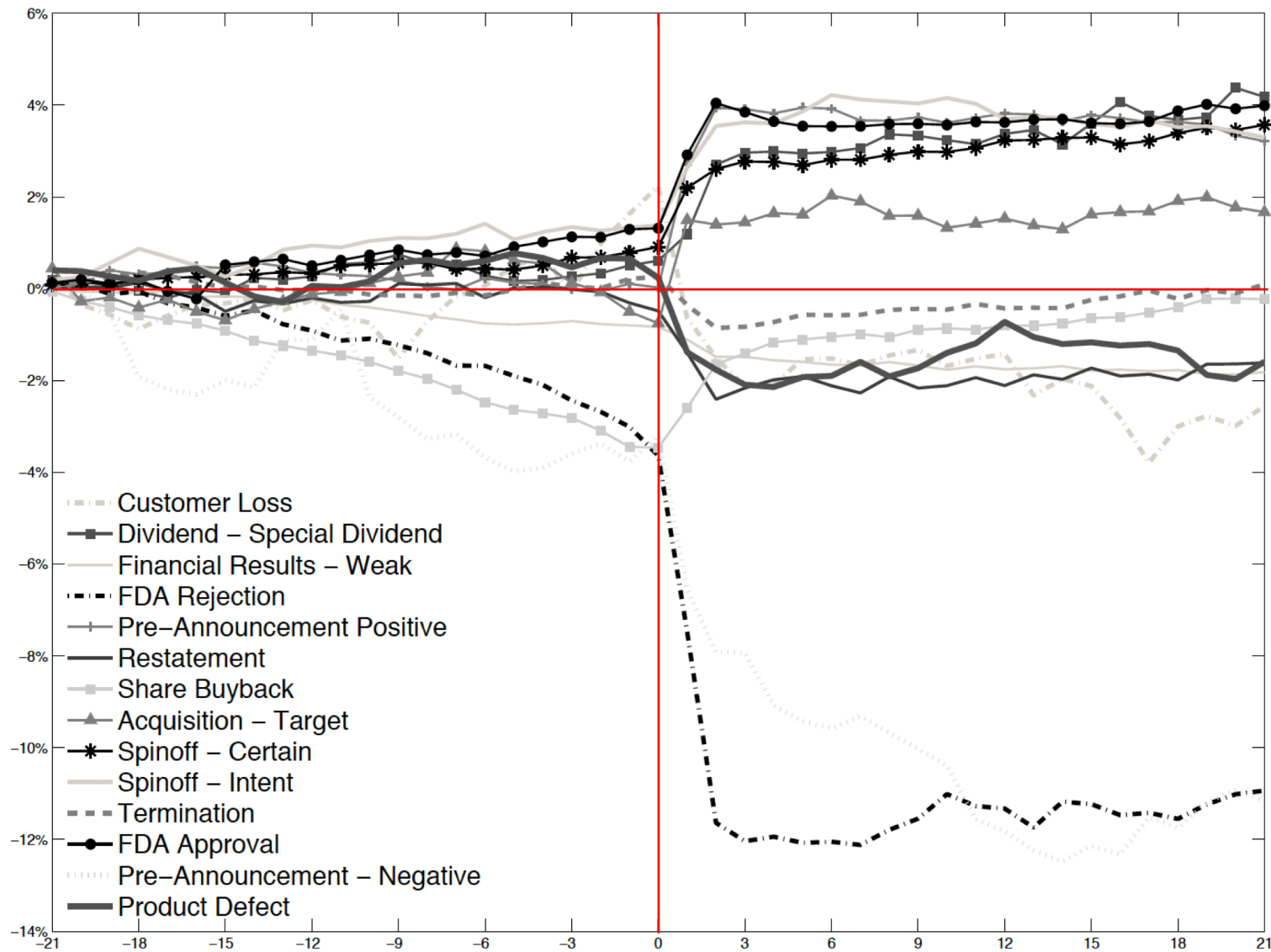
- Disenfranchisement of other investors?
- Settlements highlight how little involvement institutional investors have in the nominations process in the United States (compared to e.g. Sweden)

Market Impact of 8K Disclosure Evidence

- Large literature on market reaction to 8K disclosure and press releases
- Uses text algorithms to search, determine “tone” and sorts them by topic
- Size of runup effect (“leakage”) varies by topic

SUMMARY STATISTICS: KERNEL DENSITY PLOT OF FORM 8-K FILINGS OVER TIME. The plot below illustrates the volume of Form 8-K filings over time in both our treatment and control groups; as shown below, the incidence of Form 8-Ks in each group over time is statistically indistinguishable.





Neuhierl, Andreas, Anna Scherbina, and Bernd Schlusche. "Market reaction to corporate press releases." *Journal of Financial and Quantitative Analysis* 48, no. 4 (2013): 1207-1240.

Does the presence of the activist on the board “cause” the leakage?

- Alternative explanation
 - Presence of the activist probably changes the news flow (e.g. more M&A)
 - M&A announcements have larger runup effect than other news in any case
 - Activist “causes” more leaky announcements, not leak, leading to the observed pattern without the activist leaking
 - To exclude this interpretation would have to conduct a more in depth 8K event study; classify news; check composition of news flow
- Identification
 - Is there information the board does not see before disclosure? Company only has four days to notify.
 - “Leaks” different for positive and negative CAR? To benefit from negative CAR requires going short. Requires sophistication.

Who leaks, who trades?

- Does the activist trade itself?
- Does the activist “leak” to other activist?
 - plausible; corporate raider debate reloaded
- Does the management “leak” to active funds in return for support against the activist?

Free Rider Problem

- Is a certain degree of insider trading (leakage) a solution to the Grossman-Hart free rider problem, in the context of hedge fund activism?

Practical Reforms

- No direct evidence that activist employees on boards “leak” to the activist fund, other activists or third parties
- Hard to justify reforms targeted exclusively at hedge fund activists based on the presented evidence
- Plausibility of leaks to wolf packs is probably not enough.
- However

Broader Implications

- Strategic “leaking” of insider information to certain blockholders is an important topic that has been overlooked
- Issue is not confined to activists and activist settlements; management could leak strategically
- Hard to understand why securities regulators are unable to investigate anomalies more systematically and thoroughly using modern technology