HEDGE FUND ACTIVISM AND IMPACT ON CORPORATE SOCIAL RESPONSABILITY

PRESS REVIEW

2020

This report compiles the press articles released after the publication of two scientific papers published in the Academy of Management Journal and the Strategic Management Journal, top academic journals in management.

TABLE OF CONTENTS

LA VERITE SUR L'IMPACT DES FONDS SPECULATIFS ACTIVISTES

Harvard Business Review France – January 25, 2020

CHRONIQUES D'EXPERTS **STRATÉGIE**

La vérité sur l'impact des fonds spéculatifs activistes

Le 25/02/2020 par **Mark Desjardine** , **Rodolphe Durand**

A l'heure où les campagnes des fonds spéculatifs activistes gagnent en popularité et en puissance, il devient crucial d'apporter des preuves des implications financières et non financières à long terme de leurs actions.

Unilever, Danone, Pernod-Ricard, Saint-Gobain… Depuis le milieu des années 2010, de nombreuses entreprises européennes ont été la cible de fonds spéculatifs activistes. De nombreux travaux de recherche ont démontré que le cours des actions d'une société tendait à augmenter tout de suite après l'intervention d'un fond spéculatif activiste. Toutefois, il existe bien peu d'analyses sur leurs conséquences à long terme.

Nous avons donc examiné les résultats financiers et non financiers, de 2000 à 2016, des 1 324 entreprises impactées par des fonds spéculatifs activistes aux Etats-Unis et avons comparé ces données à celles d'un panel de sociétés similaires ayant évolué sans leur intervention. Nous avons également interrogé des P-DG et des dirigeants des entreprises visées par ce type d'actions, ainsi que plusieurs responsables et fondateurs de fonds spéculatifs. Plusieurs enseignements découlent de ces travaux, qui fournissent des informations précieuses aux cadres et aux actionnaires des entreprises cotées en Bourse et ciblées par ces fonds, ainsi qu'aux régulateurs de la finance et des marchés.

Des investisseurs en mission

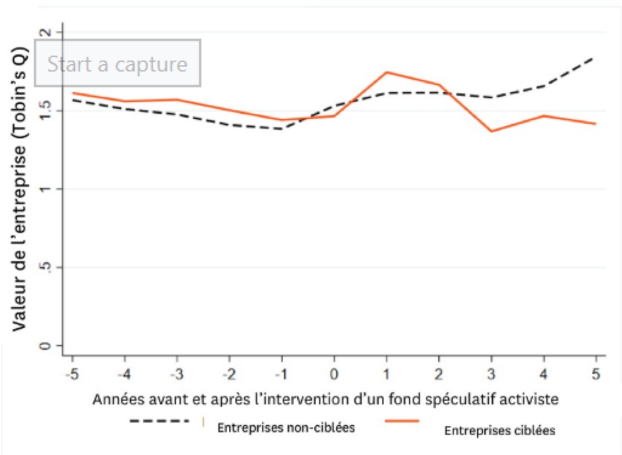
D'abord, pour éviter toute confusion : si, en général, le terme « activiste » est associé à des individus qui luttent pour défendre des causes, notamment sociales ou environnementales, il constitue en revanche un faux ami dans l'expression « fond spéculatif activiste ». Les fonds activistes sont des groupements d'investisseurs qui acquièrent les actions d'une société dans le but d'exercer un activisme d'un tout autre genre, c'est-à-dire de mettre les dirigeants sous pression pour donner davantage de poids aux voix des actionnaires (lire aussi la chronique : « Le véritable rôle du dirigeant ? Protéger l'entreprise de ses actionnaires »). Les fonds activistes s'activent donc pour générer plus de valeur économique afin de la distribuer aux actionnaires, dont ils font partie. Comme l'illustre les prises de position récente de Paris Europlace sur l'encadrement des fonds activistes, les conséquences financières et non financières de leurs actions sur le long terme font débat.

Un fond spéculatif est un groupement d'investisseurs dont l'argent est administré par une équipe de gestionnaires de fonds professionnels. De nombreux fonds spéculatifs sont passifs : ils investissent au capital d'entreprises pour reproduire un indice (le CAC40, par exemple), diversifier leurs risques et recueillir la performance moyenne de cet indice. A contrario, les fonds spéculatifs activistes injectent du capital dans une entreprise, puis prennent des mesures pour accroître la valeur de ses actions et les revendre en réalisant un gain important. Ils y parviennent, entre autres, en exigeant des sociétés une réduction des coûts et des investissements, une restructuration des actifs et une redistribution du capital en faveur des actionnaires. Puisqu'ils n'ont pas le pouvoir d'implémenter seuls ces changements, les fonds spéculatifs activistes font appel aux autres actionnaires pour soutenir leurs stratégies. Ces dernières sont considérées comme agressives et déstabilisantes par les dirigeants et les actionnaires minoritaires. Des voix s'élèvent pour remettre en question l'impact à long terme de cet activisme sur la santé des sociétés ciblées. Les fonds spéculatifs activistes réveillent-ils le management de belles endormies ou vident-ils les entreprises de leur substance ?

En 2017, Nelson Peltz, fondateur et P-DG du fond spéculatif activiste Trian Fund Management, s'attaque, au cours d'une campagne très médiatique, à un mastodonte du marché international : Procter & Gamble. Face à cet assaut, le P-DG de P&G, David Taylor, ne mâche pas ses mots contre Nelson Peltz, déclarant que ce dernier a « proposé quelque chose de très dangereux pour l'avenir à long terme de l'entreprise […] puisqu'il compte éliminer la recherche et le développement de la société. » Pourtant, en dépit des inquiétudes émises par David Taylor, les actions de P&G ont grimpé lorsque Nelson Peltz a pris des positions dans l'entreprise. Mais qu'en est-il à plus long terme, pour la performance financière et non-financière ?

Des conséquences négatives à long terme

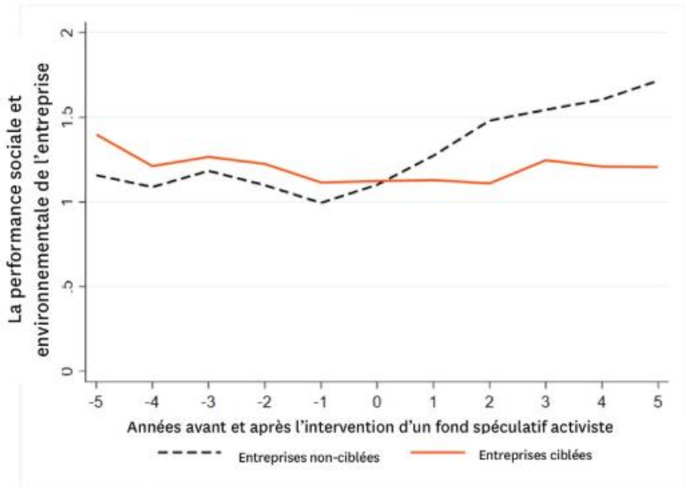
La valeur de la société augmente… puis décroît. Qu'il s'agisse de notre étude ou de recherches préexistantes, toutes les données indiquent qu'après l'intervention d'un fond spéculatif activiste, les entreprises ciblées ont connu immédiatement un pic du cours de leurs actions. Nous avons constaté une augmentation moyenne de 7,7% de la valeur de la société dans l'année suivant les actions du fond spéculatif par rapport aux entreprises les plus comparables. Mais cette croissance ne dure pas et la courbe ne tarde pas à s'inverser à l'avantage des entreprises comparables non ciblées par les fonds spéculatifs activistes. Ainsi, comme le montre le graphique 1, à moyen et long terme (de trois à cinq ans après l'entrée des activistes), les entreprises ciblées sous-performent significativement par rapport aux entreprises comparables. D'une manière générale, si l'on compare la valeur totale générée sur cinq ans, les actionnaires des sociétés ciblées ne bénéficient des actions des fonds spéculatifs activistes qu'à court terme, mais se retrouvent plutôt perdants à long terme.



Graphique 1 : la valeur de l'entreprise avant et après l'intervention d'un fond spéculatif activiste comparée à une entreprise similaire non ciblée

Les efforts de responsabilité sociale sont à l'arrêt. Deux ans après l'intervention d'un fond spéculatif activiste, les sociétés voient leurs performances sociales et environnementales être inférieures de 18% en moyenne aux résultats du groupe de contrôle. Au bout de cinq ans, ce chiffre atteint 25%, car les performances des entreprises du groupe de contrôle ont augmenté avec constance au cours du temps, alors que celles des entreprises ciblées par les activistes ont stagné. Ces résultats suggèrent que l'entrée d'un fond spéculatif activiste au capital d'une entreprise tend à geler ses démarches destinées à réduire son impact sur l'environnement et à améliorer sa responsabilité sociale. Le groupe de contrôle, quant à lui, poursuit ses efforts en ce domaine, ce qui explique un tel écart, comme l'illustre le graphique 2.

Corroborant nos données chiffrées, plusieurs responsables de fonds spéculatifs activistes nous ont expliqué considérer les efforts de responsabilité sociale et environnementale (RSE) comme du « gaspillage ». Selon l'un d'eux : « Bien sûr, je serais ravi de répondre à tous les critères ESG (environnementaux, sociaux et de gouvernance), mais si cela nous empêche d'atteindre nos objectifs, je ne vais pas m'y risquer. » L'important fondateur d'un fond spéculatif américain a par ailleurs déclaré : « Imaginons que vous vous lanciez dans une campagne activiste. Croyez-vous vraiment que vos investisseurs vont vous dire « Oui, je veux que cette entreprise qui bat de l'aile devienne totalement écolo » ? C'est suffisamment difficile comme ça de générer des bénéfices sur le marché aujourd'hui. » Du point de vue de ces responsables de fonds activistes, investir dans des plans de durabilité à long terme entre donc en conflit avec leur objectif de maximiser les performances financières à court terme (lire aussi l'article : « Comment faire aimer la durabilité aux directeurs financiers »).



Graphique 2 : les performances sociale et environnementale de l'entreprise avant et après l'intervention d'un fond spéculatif activiste comparée à une entreprise similaire non ciblée

Les dépenses opérationnelles sont drastiquement réduites. Les interventions des fonds activistes au sein des entreprises entraînent des suppressions d'emplois. A périmètre constant, nous avons constaté que la moyenne des suppressions d'emplois atteignait 4,5% – jusqu'à 7% la cinquième année. Pour une entreprise moyenne de notre échantillon, cela revient à se séparer de 383 à 642 employés par an. De la même façon, les frais de fonctionnement sont réduits : deux ans après l'entrée des activistes, la baisse est de 4,7% –

jusqu’à 6,6% la cinquième année –, une baisse qui représente des coupes budgétaires moyennes allant de 22 à 31 millions de dollars. Les dépenses en recherche et développement diminuent également, de 6 % la première année pour les sociétés ciblées par des fonds spéculatifs activistes et jusqu’à 9 % cinq ans plus tard, soit une réduction de 6 à 10 millions de dollars pour une entreprise de taille moyenne. Les entreprises réduisent donc toutes leurs dépenses sous la pression des fonds spéculatifs activistes.

Les fonds spéculatifs activistes prennent des risques en investissant dans des entreprises et leur objectif consiste à revendre leurs actions peu de temps après l’achat initial. Certains les conservent pendant un ou deux ans, trois dans des cas extrêmes, mais la plupart s’en défont dès qu’un bénéfice suffisant a été dégagé pour les actionnaires (et donc pour les investisseurs qui leur ont confié leur argent). Les responsables des fonds spéculatifs activistes sont évalués tous les mois et récompensés pour leurs performances à court terme, ce qui les pousse à réorienter les activités des entreprises qu’ils ciblent de façon à générer une meilleure valeur de marché dès que possible. Ces obligations de résultat et cette quête constante de la performance contribuent à expliquer pourquoi les responsables des fonds spéculatifs activistes réduisent toutes les dépenses qu’ils estiment incompatibles avec une optimisation des profits au plus tôt, et pourquoi la décote qu’ils appliquent aux flux de revenus futurs est plus forte que d’autres investisseurs et actionnaires.

Mark Desjardine

Membre du centre Society & Organizations d’HEC Paris, il est professeur assistant en stratégie au Smeal College of Business de l’université d’Etat de Pennsylvanie. Avant de rejoindre le Smeal College of Business, il était professeur assistant à HEC Paris, où il enseignait le management stratégique dans le cadre du programme […]

Voir toutes les chroniques

Rodolphe Durand

Professeur à HEC Paris, titulaire de la chaire Joly Family in Purposeful Leadership, fondateur et directeur académique du centre Society & Organizations (S&O) dédié aux sujets de durabilité, lancé en 2009. Ses travaux de recherche, primés par l’American Sociological Association (2005), l’European Academy of Management (2010) et la Strategic Management Society (2014) […]

Voir toutes les chroniques

https://www.hbrfrance.fr/chroniques-experts/2020/02/29317-la-verite-sur-limpact-des-fonds-speculatifs-activistes/

MANY COMPANIES AND INVESTORS SAY THEY TRY TO « DO WE BY DOING GOOD »

Financial Times, FT MORAL - March 11, 2020

Grit in the oyster

Many companies and investors say they try to "do well by doing good". As a reminder that many still fall short, here's a little grit in the ESG oyster.

It will probably come as a shock to no one that companies under attack by activist hedge funds perform poorly on "social responsibility" metrics. But research shows that activist campaigns also tank financial performance over a five-year period — meaning both shareholders and stakeholders ultimately suffer.

The study, conducted by researchers at Pennsylvania State University's Smeal College of Business and HEC Paris found that while there was an initial 7.7 per cent uptick in the value of companies within the first 12 months of being targeted, value steadily declined, dropping by 4.9 per cent four years later and continuing on a downwards trajectory after that.

At the same time, activist hedge funds tend to act aggressively to maximise the stock price of companies they invest in, often demanding that executives cut costs, scale back investments, restructure assets and redistribute cash to shareholders.

The study establishes that within five years of coming under pressure from activist investors, companies lost on average 7 per cent of their employee base while operating expenses and investment in R&D fell by 6.6 per cent and 9 per cent respectively. Compared with a control group of similar companies that had not been targeted by activists, corporate social responsibility efforts reduced following hedge fund activism, leading to a 25 per cent reduction in ESG performance within five years.

"Activist hedge fund campaigns are currently gaining in popularity and potency," said **Rodolphe Durand**, professor at HEC Paris. "So being able to provide evidence of their long-term financial and non-financial implications is absolutely critical." (*Anna Gross*)

https://www.ft.com/content/a6ebba24-632b-11ea-b3f3-fe4680ea68b5

ACTIVIST HEDGE FUND HURT BUSINESS WITH THE LONG RUN

Financial Investor – March 16, 2020

Julie Segal

PORTFOLIO

Activist Hedge Funds Hurt Businesses in the Long Run

"The bump comes early and then after that the market value is lower," a researcher says of targeted companies.

March 16, 2020

Before COVID-19 halted the global economy, European regulators watched closely as activist hedge funds increased the number of campaigns against public companies in the region. Activists have been a prominent feature of U.S. capital markets, but are relatively new to Europe.

Rodolphe Durand, a professor at business school HEC Paris, told Institutional Investor that the increase in activity prompted him and Mark DesJardine, a professor at Pennsylvania State University's Smeal College of Business, to undertake research to assess the long-term impact of financial and non-financial campaigns on public companies.

The two professors found that hedge fund activism leads to a decline in the market value of targeted companies and a decrease in the performance of social responsibility goals four and five years after the third parties intervened in these companies compared to similar firms that weren't on the radar of activists.

Durand, professor of strategy at HEC Paris and academic director of the school's Society and Organizations Center, and Penn State's DesJardine, professor of strategy and sustainability, studied 1,324 publicly-owned U.S. firms that have been the target of at least one activist between 2000 and 2016.

According to the research, the value of activist-targeted companies increases 7.7 percent within the first 12 months of being the subject of a campaign. Four years later, however, the value of these companies drops by 4.9 percent.

Within five years of being targeted, the average company sheds 7 percent of its employees and cuts operating expenses and research and development by 6.6 percent and 9 percent, respectively.

“The bump comes early and then after that the market value is lower,” said Professor Durand, in an interview. “And we see that restructuring [prompted by activists] leads to employee losses,” he added.

The study supports anecdotal evidence that activists are “hollowing out” companies in myriad ways beyond just negative impacts on stock prices and market capitalization.

In their study, the researchers compared the 1,324 targeted companies’ financial results with a control group of more than 7,600 firms that were operating during the same time period. They also compared the companies to 1,300 similar businesses that were not the target of activists.

“With hedge fund activism on the rise, determining the consequences of equity ownership by activist hedge funds on target companies’ short-term and long-term financial and social performance takes on central importance,” wrote the professors.

As for why firms do worse than peers in the longer term, Durand can only guess at the reasons, at least at this point. “Maybe there is some disengagement by employees, who suffer in a new environment,” he said.

Regulators may ultimately enact new rules to rein in activists. “Some people from market regulators have been interested in this research. Activists here are fairly new and regulatory agencies are asking how to tackle hedge fund activists,” said Durand.

Activists, however, may go away, given the chaos in global markets. These hedge funds are looking for companies to change their management, restructure or sell off underperforming divisions in order to get a stock price pop. Many companies right now are fighting to stay alive.

https://www.institutionalinvestor.com/article/b1ksg0cq4454hc/Activist-Hedge-Funds-Hurt-Businesses-in-the-Long-Run

ACTIVIST HEDGE FUNDS HURT SUSTAINABILITY

Network for Business Sustainability Blog - June 17, 2020

Activist Hedge Funds Hurt Sustainability

Maya Fischhoff · June 17, 2020

Activist hedge funds reduce companies' social and environmental sustainability and their long-term value.

No company is safe from hedge fund activism. In 2019, activist hedge funds targeted 839 companies in 19 countries. Activist hedge funds control more than $146 billion in assets, part of the more than $3 trillion hedge fund market.

A hedge fund is a specific type of investment partnership. Many hedge funds are "passive," investing in businesses and waiting for returns. "Activist" funds, by contrast, invest in order to influence a company's management and strategy. They aim to change governance structures, operational priorities, and management decisions in order to dramatically improve short-term financial performance and provide value to shareholders.

But while activist hedge funds may provide short-term gains for shareholders, they take a heavy toll on companies. If an activist hedge fund targets your company, here's what you can expect over the next five years:

Market value will increase 7.7 per cent one year after an activist hedge fund campaign, but decrease 4.9 per cent after four years and 9.7 per cent after five years.

Profitability will increase 1.1 per cent one year afterward and 1.5 per cent two years later, but then decrease in the following years.

Operating cash flow will fall 15.8 per cent in the second year and 27.1 percent in the fifth year. Corporate social and environmental performance will fall 18.6 per cent after two years and 24.8 per cent after five years.

Workforce numbers, operating expenses, R&D spending, and capital expenditures will all decrease.

This account of activist hedge funds' impacts comes from new research by Mark DesJardine (Penn State) and Rodolphe Durand (HEC Paris). They studied 1,324 firms that were targeted by activist hedge funds between 2000-2016. Targeting occurs when an activist hedge fund acquires shares in a company with the explicit intention to influence the control or management of a company. The researchers also interviewed numerous activist hedge fund principals and founders and the leaders of two multinational firms recently targeted.

The researchers measured sustainability, also called corporate social responsibility (CSR), by using MSCI KLD data. MSCI KLD assesses companies' performance related to community, diversity, employee relations, environment, and human rights. Activist hedge fund investment affected all these aspects of sustainability except community (e.g., philanthropic giving); diversity and the environment were most affected.

Why Activist Hedge Funds Hurt Sustainability

Activist hedge funds want to improve companies' market value: to raise the stock price so that the they can sell shares at a profit. "I have never seen a case [of hedge fund activism] where shareholder returns is not number one," the founding manager of a prominent US hedge fund told the researchers.

Most activist hedge funds focus on quick profits, typically selling their stakes between one and two years after purchasing them. During that time, they commonly increase stock price by demanding that firms cut costs or divest assets. Activist hedge funds also use proceeds from these sales to redistribute cash to shareholders through share buybacks and dividends.

As short-term shareholder benefits take precedence, the interests of longer-term shareholders and other stakeholders fall in priority. Several fund managers told the researchers that corporate social and environmental efforts appear as an extra cost that can be cut to immediately improve returns; they are unnecessary "fat." Corporate social and environmental efforts often aim to create long-term value, beyond the average hedge fund's horizon.

Ironically, even company efforts to fight off activist hedge funds can lead to drastic changes. Because activist hedge funds usually control a relatively small percentage of the company's stock, the hedge funds will often try to win over other shareholders by arguing that a company is mismanaged. In response, targeted companies may try to boost their own stock price, in ways that echo an activist hedge fund's proposed strategy. After his company was targeted, one CEO told his top 500 managers to "not work on anything in the next 9 months unless it has a direct effect on short-term profitability."

The pressure of a hedge fund attack can have grim consequences throughout a company. A senior executive of a targeted company explained: "You get this pressure during a battle like this.… The pressure goes down the lines to your operational people, saying, 'Keep moving, work harder, we got to make money.' And from this, I think, there can come this rash of health issues and deaths all the way down the line. Your company has to perform better, but to do that you have to put people at risk."

Ironically, strong social and environmental performance can make companies vulnerable to activist hedge funds, DesJardine and Durand found in other research, with Emilio Marti (Erasmus University). Companies who spend more on CSR than their peers are more likely to be targeted.[1] Activist hedge funds lack reliable information on potential targets, and may interpret spending on social and environmental initiatives as a signal that the company is wasteful.

How to Protect Sustainability and Long-Term Value

Activist hedge funds have targeted many leading companies, from 3M to Unilever. But you are not powerless to resist them. Here are four actions to take.

1. Communicate with your company's shareholders and stakeholders. Tell them about the consequences of hedge fund activism for the financial and social sustainability of targeted companies. Highlight how the short-term priorities of activist hedge funds likely threaten priorities of long-term shareholders and other stakeholders.

2. Lobby policymakers. Currently, activist hedge funds escape many regulations that govern other institutional investors. Policymakers could (1) require activist hedge funds to disclose ownership positions before they accumulate a 5% position in a company (the current threshold for regulatory disclosure), and (2) regulate the coordination of groups of activist hedge funds, also known as “wolf packs.” Earlier awareness of activist hedge funds’ intentions would allow companies to prepare for an attack, instead of being blindsided.

3. Seek long-term shareholders. Socially-minded and long-term shareholders can moderate an activist hedge fund’s focus on short-term profits. To attract these shareholders, clearly communicate how long-term strategies, especially those focused on CSR, will create future value. Highlight this long-term value creation story at road shows and investor meetings.

4. As an investor, reconsider your investment portfolio. Pension funds and endowments have been primary investors in activist hedge funds in recent years. Many individuals, through retirement plans or other investments, are personally invested in activist hedge funds — which may contradict their social priorities. Alternatives exist in sustainable finance and impact investing.

Additional Resources

For advising on shareholder activism and/or models based on these data, contact Mark DesJardine at desjardine@psu.edu.

[1] A company's probability of being targeted by an activist hedge fund increases from roughly 3 per cent to 4 per cent per cent when its corporate social responsibility (as measured by KLD) increases by one standard deviation above the average level of CSR. When a firm's CSR increases by two standard deviations above the average, its probability of being targeted nearly doubles, rising to 5.1 per cent.

https://www.nbs.net/articles/activist-hedge-funds-hurt-sustainability?utm_campaign=meetedgar&utm_medium=social&utm_source=meetedgar.com

COMPANIES THAT SPEND ON SOCIAL CAUSES RISK HEDGE FUND CHALLENGE: STUDY

New York Times, Reuters - June 23, 2020


The New York Times

Companies That Spend on Social Causes Risk Hedge Fund Challenge: Study

By Reuters

June 23, 2020

(Reuters) - U.S. companies that spend more on social and environmental causes, such as sustainability or charitable donation programs, are more likely to attract hedge funds that challenge their strategy and board, according to a new academic study.

(Reuters) - U.S. companies that spend more on social and environmental causes, such as sustainability or charitable donation programs, are more likely to attract hedge funds that challenge their strategy and board, according to a new academic study.

The study's findings underscore the pressure on companies to balance the interests of Wall Street and Main Street as management fields calls to protect companies' share price while doing more to tackle social inequality. This tension has intensified in the wake of the COVID-19 pandemic and U.S. protests over racism and policing after the death of a Black man, George Floyd, in police custody.

U.S. companies have about a 3% chance on average of being targeted by an activist hedge fund, but the probability nearly doubles for those who are top spenders on corporate and social responsibility (CSR) programs, according to the study, which analyzed 506 instances of shareholder activism between 2000 and 2016.

"CSR spending can be an indicator (to hedge funds) that there might be some wasteful spending at companies and that maybe top management isn't focused on the short-term returns," one of the study's authors, Pennsylvania State University professor Mark DesJardine, said in an interview.

While hedge funds are rarely explicit in their demands to companies about doing away with CSR spending, their focus on cost-cutting often results in the scaling back of these programs, according to the study. As a result, the targeted companies become reluctant to invest in CSR, even after the hedge funds have cashed out on their stock.

"*We see CSR flatline for up to five years" after an activist exerts pressure to boost short-term profitability*", DesJardine said.

For example, Motorola Solutions Inc, which was spun out of telecommunications firm Motorola in 2011 under pressure from activist investor Carl Icahn, cut CSR spending by 50% over the following three years, according to data provider KLD Global Socrates.

CSR investing has become important for many younger investors and has been backed by pension funds who have also fueled investments in hedge funds over the years.

One of the world's most prominent activist shareholders, Jeffrey Ubben, said on Tuesday he was stepping down from the hedge fund he founded in 2000, ValueAct Capital, because he believes his focus on social and environmental investments can no longer "peacefully co-exist" with traditional shareholder activism. He is launching a new firm focused on CSR investments.

DesJardine said that the economic uncertainty fueled by the pandemic will pit the need of many companies to protect profits by cutting costs against calls by their customers, vendors and others to demonstrate a strong social conscience.

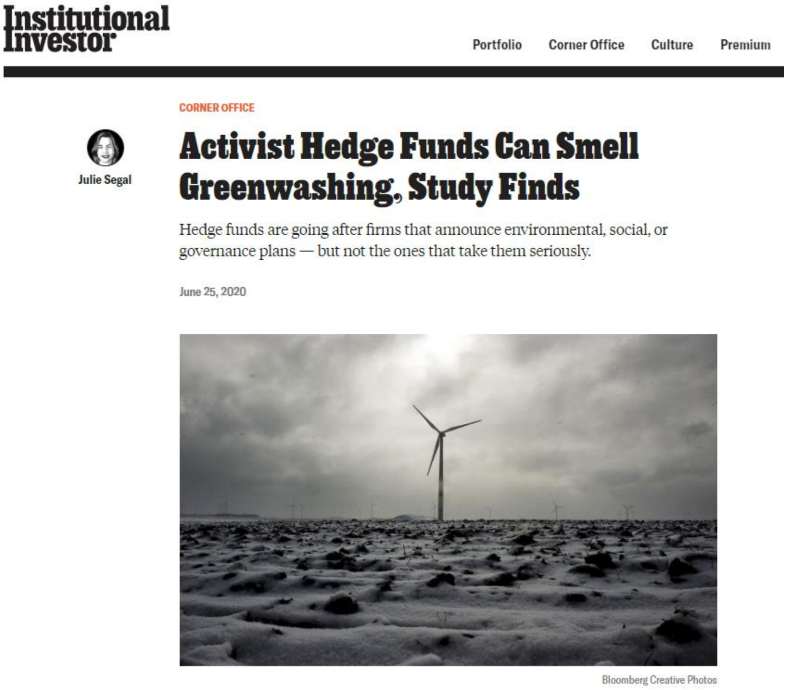
"*This will increase the tension companies face when deciding how to balance social spending and short-term profitability pressures*," DesJardine said.

(Reporting by Svea Herbst-Bayliss in Boston; Editing by Greg Roumeliotis and Aurora Ellis)

https://www.reuters.com/article/us-companies-hedgefunds-socialresponsibi/companies-that-spend-on-social-causes-risk-hedge-fund-challenge-study-idUSKBN23U3D0

ACTIVIST HEDGE FUNDS CAN SMELL GREENWASHING, STUDY FINDS

Institutional Investor – June 25, 2020



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Julie Segal

Activist Hedge Funds Can Smell Greenwashing, Study Finds

Hedge funds are going after firms that announce environmental, social, or governance plans — but not the ones that take them seriously.

June 25, 2020

Bloomberg Creative Photos

Hedge funds are going after firms that announce environmental, social, or governance plans — but not the ones that take them seriously.

Companies implementing social responsibility plans are twice as likely to enter activist hedge funds crosshairs as firms that are not addressing these issues. But management teams that are truly serious, not just greenwashing, about environmental, governance and other impact goals, may be able to avoid luring activists, according to new academic research.

Investors are increasingly deploying money via ESG and impact frameworks. Even Jeff Ubben, founder of $16 billion ValueAct Capital, is quitting to start an impact fund. Skeptics have long believed that a financial crisis would reduce the amount of attention paid to what are often considered soft issues like board diversity or the environmental impact of manufacturing plants. But investors have actually doubled down on ESG strategies since the pandemic shut down economies in March.

For companies wanting to get in on those capital flows (or do the right thing), the new study sheds light on how activists may react to ESG initiatives.

“We asked, ‘Is corporate social responsibility (CSR) a signal, according to hedge fund activists, that a firm is over-investing in long-term projects?’” said Rodolphe Durand, professor of strategy at HEC Paris and a co-author of the research, in an interview. “It could be for the simple reason that CSR is about long-term projects. If I’m an activist, and if I want a return over the next 18 months, I can think this firm is thinking too far down the road. I can get them to make changes that are profitable to me because they are not necessarily maximizing short-term shareholder value.”

The study, evaluating data on U.S.-based activist campaigns from 2000 to 2016, found that hedge funds are significantly more likely to target companies that have a strong performance record in corporate social responsibility. In fact, the likelihood of a company being targeted increased from 3 percent to 5 percent if their CSR scores rose by two standard deviations above the average. If companies are trying to do the right thing in industries that have historically not addressed environmental, social, or governance issues, they’re even more likely to be in the sight lines of activists, according to the study.

Durand said it comes down to activists believing that these initiatives are a waste of money and that management is distracted from their core duty of maximizing profits. But he said there is good news for companies that want to pursue ESG without luring activists: be serious about it.

Although social responsibility can put an target on a company's back, management teams that clearly articulate their operational and financial strategies for impact and ESG initiatives have a better chance of escaping an activist campaign than those who are vague about their plans. “*Vague financial communication strengthens the relationship between a firm’s CSR activities and the likelihood that this firm will be targeted by an activist hedge fund,“* wrote the authors in the study.

To assess a company's seriousness and clarity of its plans, the authors used natural language processing to analyze the words that managers used to describe their ESG plans during conference calls. If managers frequently used vague words (measured as a percentage of overall language used) like would, should, and could as well as future tenses — signaling that ESG work may be years off — then they were more likely to be attacked by activists.

Durand said the lessons of the study are important in light of his previous research, showing that market value of companies targeted by activists increases in the first two years after a campaign. But after that, they underperform peers that have been left alone. “There’s a 25 percent differential," Durand pointed out. He added that management should do whatever it can to prevent activists from gaining a foothold.

"*Firms are more likely to be attacked if they showcase CSR strategies, but especially if they greenwash. Take note*."

https://www.institutionalinvestor.com/article/b1m72r85v3slnb/Activist-Hedge-Funds-Can-Smell-Greenwashing-Study-Finds

ETHICAL CSR FOCUS TRIGGERS HOSTILE INVESTOR ACTIVISM, STUDY FINDS

Financial Times – August 3, 2020

Ethical CSR focus triggers hostile investor activism, study finds

Academics say hedge funds may see approach as a costly distraction — but attitudes are shifting

A protest against mad-made climate change in Australia. Companies backing ethical causes can please customers but annoy investors © Jenny Evans/Getty Images

Academics say hedge funds may see approach as a costly distraction — but attitudes are shifting

Companies that rank highly on corporate social responsibility measures are more likely to be the target of hedge fund activism, academic research has found.

This is because some activist investors view CSR as a sign that a company is wasting money rather than focusing on shareholder returns, according to research conducted by Pennsylvania State University's Mark DesJardine, Erasmus University's Emilio Marti and HEC Paris business school's Rodolphe Durand.

That is particularly the case if such hedge funds activists, which tend to target and call for a shake-up at inefficient companies, view a company's efforts to do good as little more than superficial greenwashing.

> **Activist hedge funds look at CSR as a signal of relative misalignment**
>
> **Rodolphe Durand, HEC Paris business school**

The research looked at 506 US-based activist campaigns between 2000 and 2016 and found that companies whose CSR ratings were above the industry average had a 5 per cent chance of being subject to hedge fund activism. That compares with a 3 per cent likelihood for the industry average.

In industries with poorer CSR ratings on average, companies that put greater emphasis on such issues are more likely to be targeted, the research also found.

"Activist hedge funds look at CSR as a signal of relative misalignment" with delivering shareholder returns, says Prof Durand.

A focus on ethically-oriented practices was seen as a sign of wasteful spending, which "prevent[s] firms from maximising shareholder value in the short term", wrote the academics, who also interviewed a range of hedge fund managers for their research.

The findings coincide with a surge of interest in environmental, social and governance investing in recent years, which is helping persuade companies to improve their reputations for ethical behaviour to attract investors. Global sustainable investing assets totalled more than $30tn in 2018, according to the Global Sustainable Investment Alliance, up from $22.8tn in 2016.

While the coronavirus crisis has diverted some investors' focus this year, many in the industry believe demand for this type of investing will continue to grow.

Paul Polman, Unilever's former chief executive, is among business leaders who have stuck to their guns in defending broader ESG mandates when challenged by outside investors. After he fended off an unsolicited $143bn takeover approach from Kraft Heinz and its private equity investors in 2017, he described the abortive bid for Unilever as "a clash between people who think about billions of people in the world and some people that think about a few billionaires".

HEC's Prof Durand says he believes that conclusions from the research, which goes only up to 2016, are still valid despite a recent pick-up in ESG investing. He says that activist hedge funds are not fundamentally opposed to a company focusing on CSR, but rather concerned that it was an indicator of greater waste. Signalling credentials in corporate social responsibility "can be a cosmetic signal sent to customers" without any clear proof that it generates value for shareholders, he says.

> “
> **An activist today should actually aim at pushing companies toward best-in-class and authentic CSR strategies**
>
> Quentin Dumortier, Atlas Global Investors

But there have been signs that parts of the hedge fund industry, known for its focus on profits, have started to view ESG as being in line with shareholder returns. Man Group and Caxton Associates are among fund managers that have been exploring ways to profit, while Marshall Wace has been looking to raise $1bn for a new computer-driven fund that will trade stocks based on their environmental and other ethical attributes.

Strong CSR performance creates shareholder value and is “fully aligned with shareholders’ interest”, says Quentin Dumortier, founder of hedge fund firm Atlas Global Investors. “An activist today should actually aim at pushing companies toward best-in-class and authentic CSR strategies as a powerful driver to create shareholder value.”

Some commentators argue however that the idea that better ESG ratings will lead to better returns is false and instead see unnecessary costs incurred through ethical behaviour in many areas.

The researchers also note that unintended attention from activist hedge funds concerned by CSR distractions can create additional costs for targeted businesses. These could include hiring lawyers or a public relations specialist, or the loss of focus as top management respond to the activist attack. Countering a hostile activist can cost tens of millions of dollars or more.

Prof Durand adds that the impact of hedge funds on companies’ ethical efforts is not straightforward. Nor is it always negative if clearly communicated. Explaining how CSR meshes into the business model reduces the chances of becoming an activist target, he says.

Hedge funds targeting such companies “are not anti-CSR, per se”, Prof Durand argues. But their scepticism over the benefits of ESG commitments made by companies is “because they prefer shorter-term rather than longer-term returns”.

https://www.ft.com/content/2ab06d51-bb6d-4f41-88cf-b220b2a4bcd1?FTCamp=engage/CAPI/website/Channel_muckrack//B2B

ACTIVIST HEDGE FUNDS: GOOD FOR SOME, BAD FOR OTHERS?

Knowledge@HEC -

ARTICLE

Activist Hedge Funds: Good for Some, Bad for Others?

STRATEGY

Do activist hedge funds help or harm the companies they target? Mark DesJardine of Pennsylvania State University's Smeal College of Business and Rodolphe Durand of HEC Paris (members of the HEC's Society & Organizations Institute) investigated the long-term effects of hedge fund activism on companies that get targeted by these activists. In their extensive research, they found the value of targeted companies spikes the first year after targeting but drops in later years relative to similar non-targeted companies. In addition, the authors found that being targeted by activist hedge funds put a halt to the broader investment portfolios and socially responsible efforts of companies.

When we hear the word "activist", we conjure up images of Greta Thunberg standing in Trafalgar Square speaking out about climate change, or anti-war protestors in Paris venting into megaphones. While we typically think of activists as those fighting to advance environmental or social causes, in this sense, the term "activist hedge fund" is something of a misnomer. Activist hedge funds are investors that purchase shares of companies to become active in a different way: they shake management with an aim to make the voice of shareholders heard more loudly. But, as activist hedge funds voice their concerns, we must ask: what are the long term financial and non-financial consequences?

ACTIVIST HEDGE FUNDS: INVESTORS ON A MISSION

In 2016, Nelson Peltz, founder and CEO of activist hedge fund Trian Fund Management, targeted the behemoth Procter & Gamble in a very public campaign. Upon being targeted, P&G's CEO David Taylor lashed out against Peltz, claiming he "proposed something very dangerous for the long-term future of this company… eliminating our corporate R&D." Despite Taylor's concerns, the shares of P&G have steadily risen since Peltz initially targeted the company. But, with sharply rising stock prices, it raises a series of questions about which changes activist hedge funds implement and how those changes will affect the long-term vitality of the companies they target.

A hedge fund is a limited partnership of private investors whose money is managed by a team of professional fund managers. Many hedge funds are passive in the sense that they invest in businesses and then wait for returns to arise over a given time period. In contrast to these more passive funds, activist hedge funds aim to invest in businesses and then take actions that boost the companies' stock price before selling the shares for a profit soon afterwards. Among other demands, they do this by demanding that companies cut costs, scale back investments, restructure assets and redistribute cash to shareholders. While alone they don't have the power to make these changes, activist hedge funds can have their demands met by calling upon other shareholders to support their demands. Activist hedge funds' strategies are sometimes described as aggressive and destabilizing by minority owners and management.
Indeed, some question the long-term effects of activism on the sustainability of targeted companies. Does hedge fund activism redress sleepy management and refocus their attention on shareholders' interests or does it hollow out the targeted companies?

TAKING THE LONG VIEW

Since mid-2010, many European companies have been targeted by activist hedge funds, including Unilever, Danone, Pernod-Ricard, among others. Plenty of research has shown that a company's stock price tends to increase immediately after being targeted by an activist hedge fund, but research has been lacking into the long-term consequences.

From 2000 onwards, we assessed the financial and non-financial results of 1,324 companies over five years that had been targeted by activist hedge funds and compared the data with companies that had not been targeted. We interviewed CEOs and other executives of companies that had come under the sights of activist hedge funds, as well as numerous managers and founders of hedge funds. Our key findings follow.

1. Company value rises and then falls

In both our sample and in prior research, after being targeted by an activist hedge fund, companies experience an immediate rise in their value. Our research finds a 7.7% uptick in company value in the year following targeting. However, this rise is short lived as it turns negative. In the years that follow, the value of the companies targeted by activist hedge funds steadily drops, falling 4.9% four years after targeting and continuing downwards five years after targeting. Overall, when comparing the total value generated over five years, shareholders of targeted companies benefit from hedge fund activism in the short term but seem at a disadvantage in the later years.

After being targeted by an activist hedge fund, companies experience an immediate rise in their value. However, this rise is short lived as it turns negative.

2. Corporate social responsibility plans are abandoned

Two years after being targeted by an activist hedge fund, companies see their corporate social performance fall by 18% on average. By year five, this number becomes 25%. This compares unfavourably to the matched sample of companies that were not targeted by activist hedge funds, where corporate social responsibility efforts steadily rose. The results suggest that as soon as an activist hedge fund takes ownership of a company's shares, the company is likely to firmly place on hold their efforts to be more environmentally sustainable and socially responsible while the non-targeted firms keep improving–which explains the striking difference.

Corroborating our quantitative results, several activist hedge fund managers we spoke to viewed corporate social responsibility efforts as potentially wasteful. One activist hedge fund manager warned, "Of course I would be glad to be ESG [environmental-social-governance] conscious and responsible, but if that means I'm going to underperform, I'm not going to do it." A prominent founder of a U.S. hedge fund explained: "Let's say you go activist on someone. Are you really going to have investors saying, 'Yeah I want this beat-up company to be green?' It's hard enough to make money in this market." In the view of these activist hedge fund managers, investing in long-term sustainability plans can conflict with maximizing short-term financial performance—which many of their investors likely prioritize.

3. Spending is slashed

There are immediate and steady job losses after an activist hedge fund targets a company. Controlling for changes in company size, after one year, the number of job losses amount on average to 4.5%, which continues to grow to 7% by year five. For an average company in our sample, this equates to a loss of 383 to 642 employees. Like job losses, operating expenses fall at companies targeted by activist hedge funds. Two years following targeting, operating expenses fall by 4.7% and continue falling, by 6.6% in year five. This equates to average cutbacks in spending of between $22 and $31 million. Research and development spending also decreases, by 6% in the first year after a company is targeted and by 9% five years later, equating to cutbacks of between $6 and $10 million for an average-sized company. Across the board, companies slash spending after coming under pressure by activist hedge funds.

DISCOUNTING FUTURE CASH FLOWS

Our interviews with managers at activist hedge funds confirmed that they take risks when investing in companies and aim to sell their shares in companies shortly after their initial purchase dates. Sometimes they would hold shares for one to two years and in extreme cases for three years, but ultimately they would exit as soon as value was created for shareholders. Because managers at activist hedge funds are evaluated on a monthly basis and rewarded for short-term performance, they are driven to reorient companies' activities in a way that generates market value sooner rather than later. These incentive structures and performance pressures help explain why activist hedge fund managers curtail spending that they judge will be unlikely to maximize value in the short term.

The data we collected further suggests that when an activist hedge fund takes ownership of a company's shares they can rapidly reconfigure the company, maximizing its profitability and market performance. However, we found that compared with similar non-targeted companies, the costs of these financial gains are later incurred down the line by other stakeholders, including employees and long-term shareholders.

Methodology

We identified 1,324 companies that had been targeted by at least one activist hedge fund between 2000 and 2016 by assessing filings from the U.S. Securities and Exchange Commission (SEC) and data from Activist Insight, an organization that tracks shareholder activism. The SEC requires that hedge funds notify them whenever they acquire 5% or more of any class of securities of a publicly listed company if they intend to actively influence the management of that firm. We then compared targeted companies' financial results with a sample of 7,670 control companies that were not targeted during our study window. We also used a matched sample, where we compared the 1,324 targeted companies' results to the results of 1,324 similar but non-targeted companies. Matching allowed us to compare the impact of activist hedge fund targeting on companies that had been targeted with closely matched companies that hadn't been targeted.

Applications

At a time when activist hedge fund campaigns are gaining in popularity and potency, providing evidence on the long-term financial and non-financial implications of hedge fund activism is critical. Based on 16 years of these campaigns, our research provides valuable guidance to executives and shareholders of any publicly owned company targeted by an activist hedge fund, as well as to policy-makers looking to address the regulatory freedom of hedge fund activists.

Based on an interview with Mark DesJardine and Rodolphe Durand and on their academic paper, "Disentangling the effects of hedge fund activism on firm financial and social performance" (Strategic Management Journal, January 3, 2020).

HEDGE FUND ACTIVISM'S IMPACT ON CSR PERFORMANCE

VIDEO : February 27, 2020

We interviewed CEOs and other executives of companies that had come under the sights of activist hedge funds

https://www.youtube.com/watch?v=jaFssOBAqkY&feature=emb_logo

WHY ACTIVIST HEDGE FUNDS TARGET SOCIALLY RESPONSIBLE FIRMS, AND HOW EXECUTIVES AND INVESTORS CAN COUNTERACT THEM

Knowledge@HEC – July 2, 2020

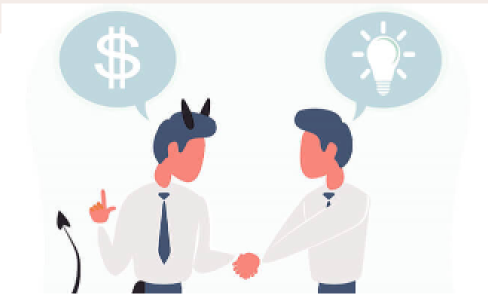
ARTICLE

Why Activist Hedge Funds Target Socially Responsible Firms, and How Executives and Investors Can Counteract Them

STRATEGY

JULY 02ND, 2020

Increasingly powerful and influential, activist hedge funds are forces to be reckoned with. With their controversial tactics aimed at maximizing shareholder profit, they undermine sustainability practices, which they consider wasteful. Indeed, not only do they tend to suppress the corporate social responsibility (CSR) activities of the companies they target, they also target companies with stronger CSR records in the first place, as a new study reveals. But its authors Mark DesJardine, Rodolphe Durand, and Emilio Marti also show that these companies can divert the attention of activist hedge funds, and that policymakers and socially minded investors can intervene, too.



Increasingly powerful and influential, activist hedge funds are forces to be reckoned with. With their controversial tactics aimed at maximizing shareholder profit, they undermine sustainability practices, which they consider wasteful. Indeed, not only do they tend to suppress the corporate social responsibility (CSR) activities of the companies they target, they also target companies with stronger CSR records in the first place, as a new study reveals. But its authors Mark DesJardine, Rodolphe Durand, and Emilio Marti also show that these companies can divert the attention of activist hedge funds, and that policymakers and socially minded investors can intervene, too.

WHAT HAPPENS WHEN HEDGE FUNDS ATTACK?

Activist hedge funds control more than $146 billion in assets, part of the more than $3 trillion hedge fund market. No company can afford to ignore them, or believe they are too large to be targeted. In 2019, 839 companies across 19 countries found themselves in the crosshairs of at least one activist hedge fund, including 21% of companies where market capitalizations exceeded $10 billion.

What happens after being targeted? As investors with short investment horizons, activist hedge funds take actions that boost short-term shareholder value at the expense of long-term investments. CSR tends to be a collateral damage, with social performance falling by nearly 25% within five years, as we demonstrated recently. But hedge fund activism is even more problematic than our previous research shows. Not only do targeted companies curtail their CSR activities, their sustainability efforts make them even more likely to be targeted in the first place, as our newest research reveals.

WHY STRONG CSR MAKES COMPANIES MORE VULNERABLE TO HEDGE FUND ACTIVISM

We studied more than 500 companies between 2000 and 2016, a period of intense hedge fund activity, and found that companies who spend more on CSR than their peers are more likely to be targeted. To be precise, a company's probability of being targeted by an activist hedge fund nearly doubles – from 3.04% to 5.11% – when its CSR score increases by two standard deviations above the average.

Why do companies with sustainability policies make such attractive targets? To be forthright, activist hedge funds view spending on the environment or the community as investments with uncertain and very distant returns, and so prefer redirecting that spending to activities that maximize value for shareholders in the short term. One hedge fund manager interviewed for the purpose of our study spoke of CSR as “wasteful” spending, and another said “cutting the fat” is necessary. In other words, these investors see CSR as cost-cutting potential. Hence their targeting strategies.

A STRONGER EFFECT WHEN CSR STANDS OUT

Our interpretation is further supported by the additional results of the study. Firstly, we looked at individual CSR scores compared to industry averages. We found the targeting effect on CSR is less strong if companies “blend in” with what is considered normal in the sector. Specifically, the positive effect that CSR has on the probability of a company being targeted by an activist hedge fund increases when companies are in industries where spending on CSR is

less common. In other words, standing out as socially responsible makes companies even more vulnerable to targeting.
Secondly, we examined the signals that companies send out both through their words and their actions. Companies with high CSR activities are less targeted if they practice very clear financial communication to markets. Why? When investors have only vague financial information, they turn to CSR actions to better gauge whether a company's strategic priorities misalign with short-term shareholder primacy. Conversely, if executives are clear about their financial results and projections, resources allocated to CSR are less likely to be perceived as wasteful. In other words, through their communication practices, potential targets can fight back. Yet, not only do executives have ways of deflecting the attention of hedge fund activists, but other stakeholders have a role to play, too.

IMPLICATIONS FOR A WIDE RANGE OF STAKEHOLDERS

1/ For publicly traded companies

As stated, executives need to be aware that standing out from their counterparts attracts activists especially when the value creation strategy is unclear. So they need to clearly communicate their strategy to existing (and hopefully more socially minded) shareholders to drum up their support when allocating capital to CSR activities – indeed, activist investors will depend on the backing of these other shareholders when targeting companies.

2/ For policymakers

Our study suggests that protecting companies from activist hedge funds may support companies' CSR efforts (which are aimed at the greater good, after all). Lawmakers in several countries are currently debating protective measures; in the Netherlands for instance, they are considering the right to a "cooling-off" period that would buy executives time after being targeted. Similarly, French policymakers are discussing whether to lower the mandatory reporting threshold (disclosure of ownership) from 5% to 3%. Earlier awareness of activist hedge funds' intentions would allow companies to prepare for an attack, instead of being blindsided.

3/ For investors

The findings of this study should encourage investors who care about sustainability to reconsider some of their investments. Today many individuals and organizations have (sometimes unwittingly) put their money in the hands of activist hedge funds through their pension funds and endowments, which have been a major driver of growth for activist hedge funds since 2009. If investors are socially and environmentally minded, they should ensure their capital is not supporting institutional investors that undermine CSR. Alternatives exist in sustainable finance and impact investing.

Many individuals and organizations have (sometimes unwittingly) put their money in the hands of activist hedge funds through their pension funds and endowments, which have been a major driver of growth for activist hedge funds since 2009.

*For models based on these data that simulate the effects of different types of shareholder activism on targeted companies' performance and other outcomes, contact Mark DesJardine at desjardine@psu.edu.

Methodology

To test our theory, we studied 506 activist hedge fund campaigns carried out in the U.S. between 2000 and 2016. We measured individual and sector CSR scores (strengths in the following domains: environment, community, diversity, employee relations, and human rights) as well as vagueness in earnings calls transcripts (the primary medium of communication regarding financial strategies) and used statistical regression to test the effects of the different variables.

https://www.hec.edu/en/knowledge/articles/why-activist-hedge-funds-target-socially-responsible-firms-and-how-executives-and-investors-can-counteract-them