



Hedge Fund Activism and the Market for Corporate Quasi-Control

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Activist hedge funds increasingly seek and secure board representation in public companies. Representation on target boards may signal a longer-term commitment to target companies that can mitigate some of the typical criticisms of traditional hedge fund activism, such as short-termism. Hedge funds may hold shares for longer periods when they obtain board seats and often become heavily involved in corporate strategy and operations. In my recent paper 'Hedge Fund Activism and the Market for Corporate Quasi-Control', available [here](#), I argue that the phenomenon of activist board representation has created an active market for corporate quasi-control, defined as power that is greater than influence but that falls short of actual corporate control.

Hedge fund activism has risen spectacularly from the ashes of the market for corporate control together with institutional investor activism that did not live up to expectations. Aggressive defences to hostile takeovers, together with unfavourable economic conditions and anti-takeover statutes, facilitated the demise of the hostile takeover in the 1980s and contributed to the insulation of the board of directors from outside forces. New hope for the shareholder movement was heralded when institutional investors, such as pension funds and mutual funds, became more active in the 1990s. However, such institutions were plagued with conflicts of interest and incentivisation and collective action problems, which meant that their activism fell short of expectations and ultimately proved to be a disappointment. Activist hedge funds stepped up to fill the void that was created.

Hedge funds are routinely criticised for being short-term in focus and hostile towards incumbent management. It is open to debate whether short-term goals are in fact problematic or are necessarily inconsistent with long-term goals. However, even if short-termism is acknowledged as potential problem, the increased prevalence of activist hedge funds seeking and securing board representation could be a positive rather than negative development.

In my paper, I argue that activist minority board representation could be a potentially effective solution to agency problems, which may still exist in companies due to the lack of an effective market for corporate control and the problems associated with other types of institutional investor activism. Hedge funds rarely control boards, so their power exists in the form of quasi-control. Their minority directors can usually only secure board seats and implement changes if they are able to convince other, largely institutional, shareholders of their value and the wider board of directors of the soundness of their strategies.

Widely criticised recent innovations in hedge fund activism such as 'wolf pack activism', where more than one hedge fund descends upon a company, and 'golden leash' compensation structures, which incentivise activist appointed directors to increase the share price of target companies, also serve to promote an active market for corporate quasi-control. Wolf packs increase the probability of activists successfully securing board representation and golden leash compensation structures help to facilitate the recruitment of well-reputed directors to board positions, improving the overall quality of activist strategy and potentially lengthening the time horizon of activist investments. Activist hedge funds seeking board representation have therefore facilitated an active market for expert board members, by sourcing non-affiliated candidates to serve on target company boards and by incentivising them through novel compensation mechanisms.

Hedge fund activists have not only filled a void by creating a new market for corporate quasi-control, they have also reincarnated the market for corporate control to some extent and have reinvigorated institutional investor activism. Activist hedge funds contribute to the market for corporate control by launching full proxy fights for control, by engaging in hostile takeovers themselves, or more commonly by identifying potential takeover targets to be acquired by a third party bidder. Activist hedge funds have also contributed to institutional investor activism by mobilising previously passive institutional investors who now play an invaluable role as corporate governance intermediaries. As activist hedge funds rely upon the support of other large shareholders in order to win their campaigns, institutional investors can provide valuable support to activist campaigns, as well as operating as an important safeguard when activist proposals may not be in the long-term interests of the company.

Activist hedge funds continue to be villainised as short-term actors in corporate governance debates. Whilst acknowledging that not all activist engagements are positive, my paper identifies recent developments in hedge fund activism that challenge the negative rhetoric. Initial evidence from cases where hedge funds have sought and secured representation on target company boards suggests that activists may have longer-term investment horizons and display a stronger commitment to improving operations and corporate strategy. Therefore, whilst further empirical work is required to assess the effect of activist board representation on shareholder value and other corporate stakeholders, at least some of the typical criticisms of hedge fund activism appear to be effectively mitigated by the phenomenon of activist board representation.

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