

The Stewardship Role of Investors



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March 2019



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INVESTMENTS





ValueAct Capital



Adobe



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Adobe: The Problems

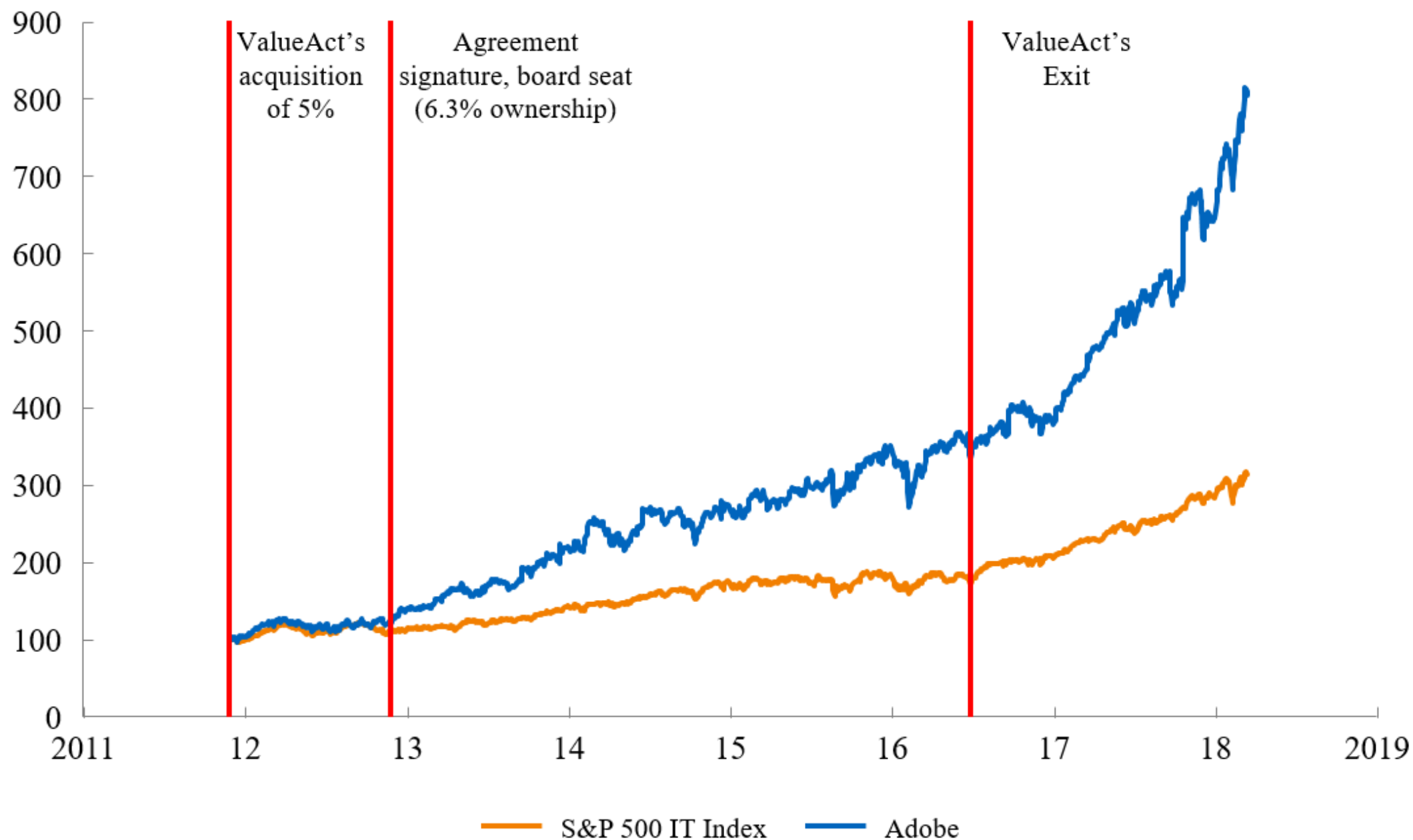
- Poor sales in Creative Suite
- Apple refused to allow Flash on its products, preferring rival HTML
- Missed mobile revolution; focused too much on desktop products
- Fired 2,000 workers between 2008-2011



Adobe: The Solution

- Late 2011, ValueAct bought a 5% stake
- December 2012, ValueAct partner Kelly Barlow joins Adobe board
- “I don’t need the quick hit. ... You can’t just keep throwing stuff at the wall, you need to get in there, get the information and work on a long-term plan that is going to be sustainable”
- Moved away from Flash, embraced HTML
- Moved to a subscription revenue model

Adobe vs. S&P 500 IT Index total return, Dec 2011 – Mar 2018

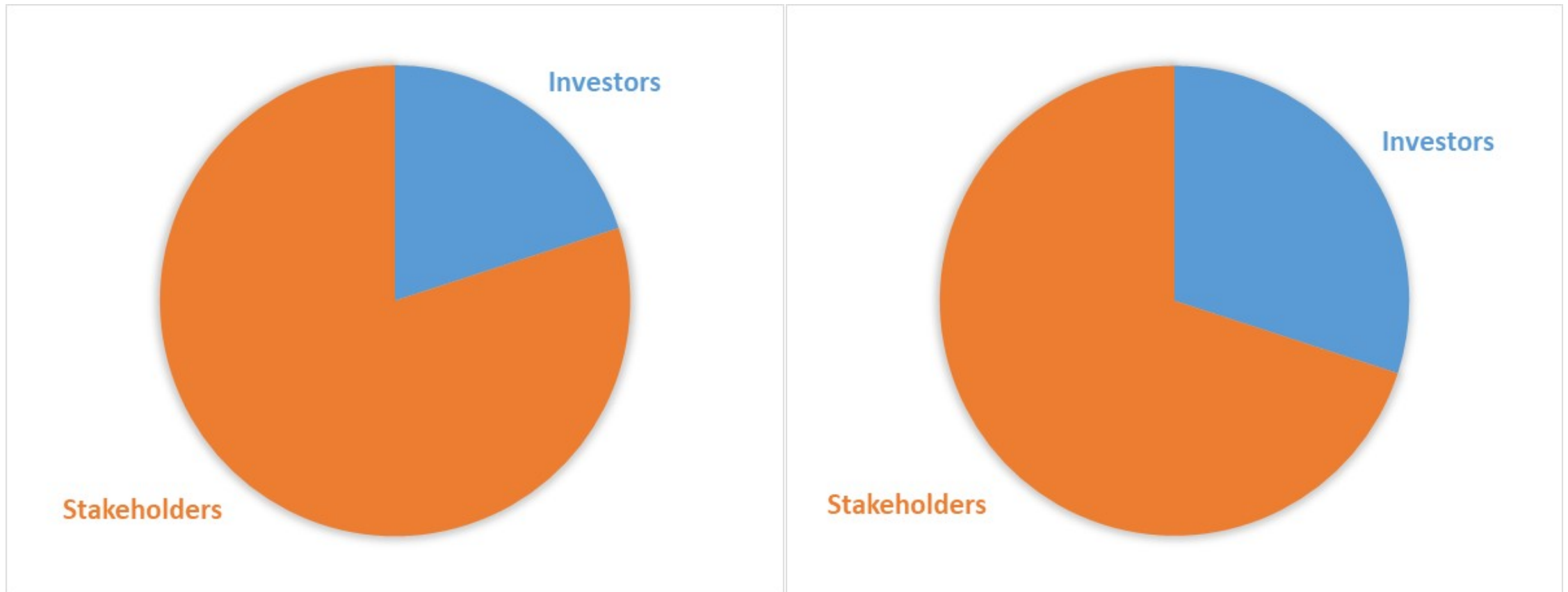




Adobe: The Aftermath

	2011	2017
Revenues	\$4.2b	\$7.3b
Employees	10,000	18,000
Tax Paid	\$202m	\$443m

The Pie-Splitting Mentality

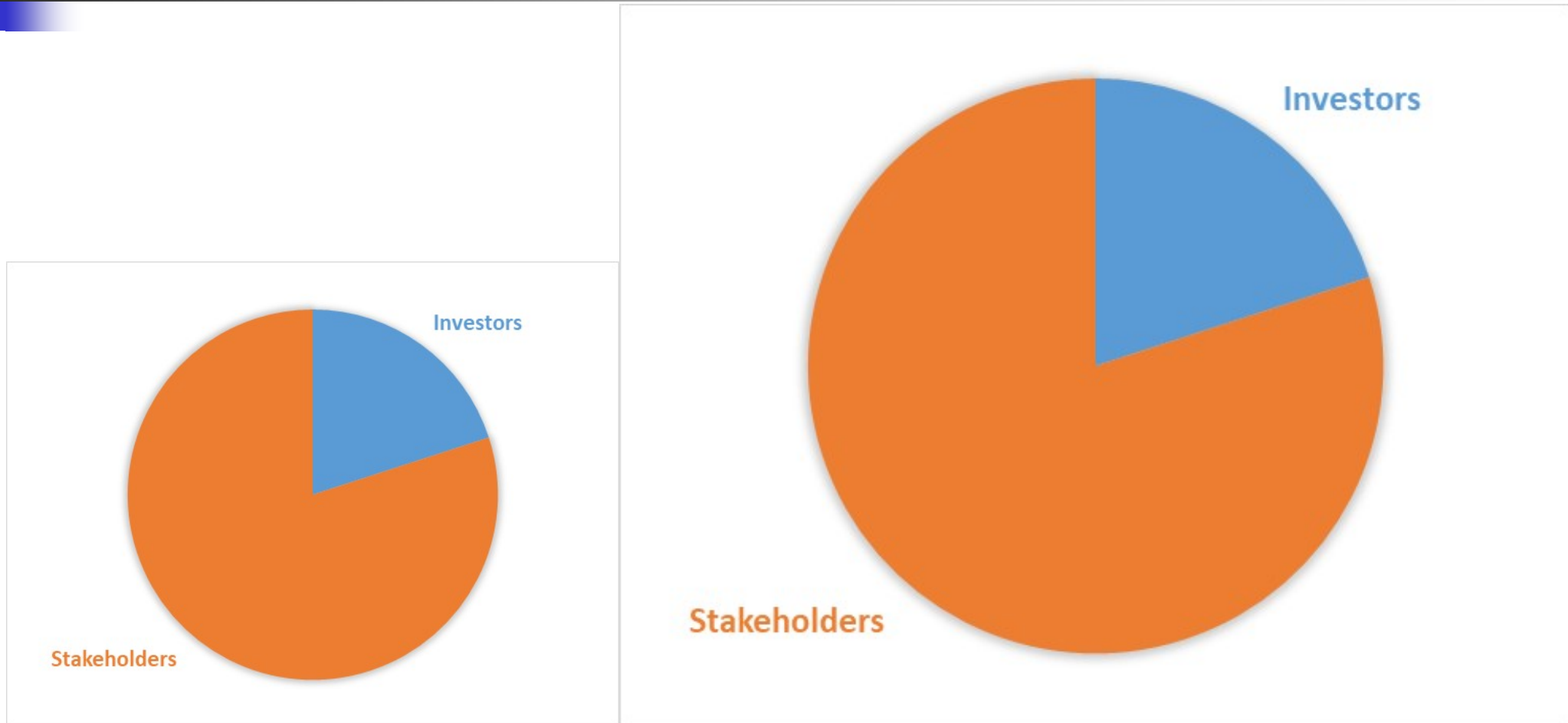




The Pie-Splitting Mentality (cont'd)

- “Terrorist activists might come in and strip out the cash, fire up to thousands of employees, ... stop training and flip the company in a number of years”
 - Peter Georgescu, author of *Capitalists, Arise!*
- Diagnosis based “on the decades of my and my firm’s experience in advising corporations”
 - Martin Lipton, “Bite the Apple; Poison the Apple; Paralyze the Company; Wreck the Economy”

The Pie-Growing Mentality

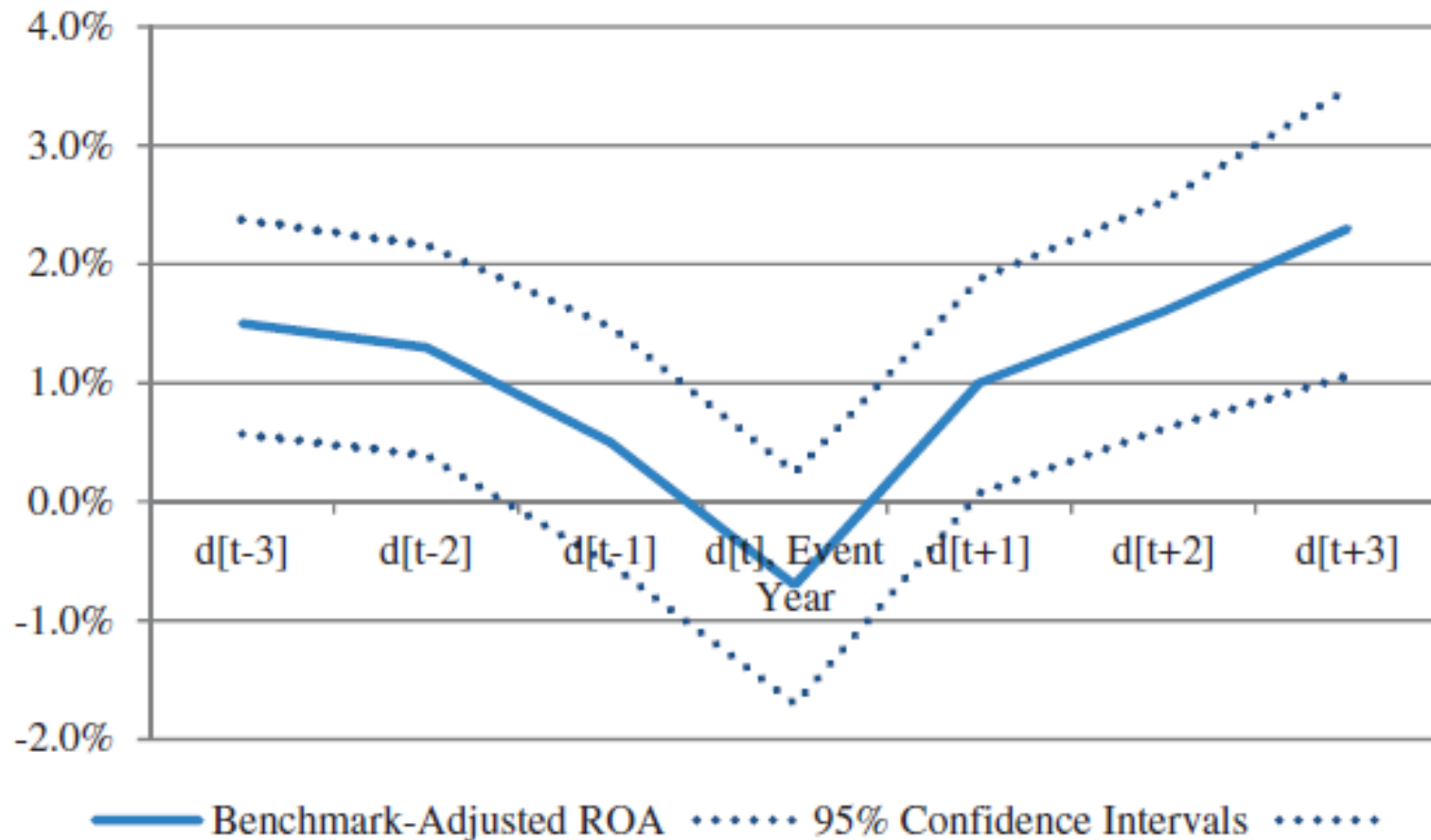




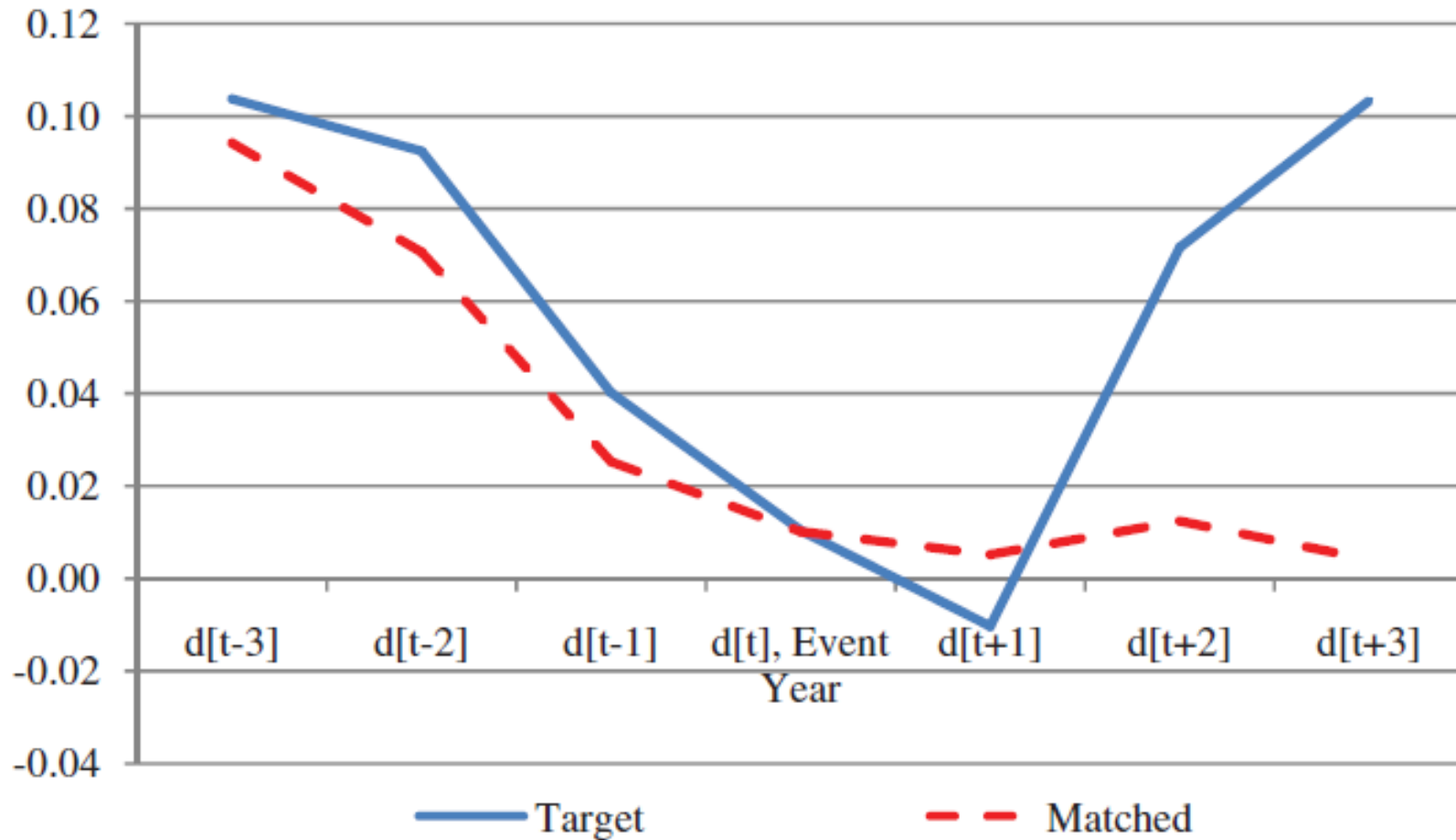
Hedge Fund Activism: The Evidence

- Series of papers by Brav, Jiang and coauthors
- Stock price increases by 7%
 - No long-term reversal. After exit (2 years), stock prices keep rising for next 3 years
- Increased ROA
- Increased total factor productivity (output vs. labour input), labour productivity
- Improvements in plants sold

Hedge Fund Activism: The Evidence



Hedge Fund Activism: The Evidence





Hedge Fund Activism: The Evidence

- IT investment rises
- R&D expenditure *falls*
 - But number and quality of patents rises
- Increased performance of sold patents, departing inventors, remaining inventors
- Higher CEO turnover
- New directors have better credentials, more technology and industry expertise



Investor Activism: The Takeaways

- Investors are not the enemy. They are allies with firms in growing the pie
 - Outside opinion, accelerators and brakes
 - Lipton's "Dealing with Activist Hedge Funds" uses the word "attack" 20 times
- *Does not* mean all activism creates value



Stewardship

- Stewardship is an approach to investment that improves the value an enterprise creates for society
- Two forms of stewardship
 - Engagement (“voice”)
 - Monitoring (“exit”)



The Myths

- “Joe Bower and Lynn Paine “had me at hello” ... with their new HBR article ... Investors would have an additional \$1tr, workers would have an additional 5m jobs, and the country would have more than an additional \$1tr in GDP.”
- “If you give me \$100 but say that you have the right to take it back or change the pattern of its usage with 24 hours notice, it isn’t nearly as valuable to me as if you say I can use it for 10 years for the purpose for which we agree it is intended before I am allowed to ... ask for it back”
- Tenure voting (LTSE, Loi Florange), differential capital gains tax, Toyota’s long-term shares



The Logic

- Arguments confuse the *horizon* of an investor with the *holding period*
 - Selling in the ST could be based on LT information. Disciplines management, like divestments or boycotts
 - The power of voice depends on the threat of exit (as with customers)
 - Engagement may fail (Carillion)
 - Lock-ins may deter investment to begin with
 - Loyalty schemes reward doing nothing (VW)



The Logic (cont'd)

- Vanguard CEO Bill McNabb: “Our favorite holding period is forever. We’re going to hold your stock when you hit your quarterly earnings target. And we’ll hold it when you don’t. We’re going to hold your stock if we like you. And if we don’t. We’re going to hold your stock when everyone else is piling in. And when everyone else is running for the exits.”
 - Kodak



The Evidence

- Increased liquidity
 - Improves firm value
 - Particularly for firms with blockholders and CEO incentives
 - Encourages blockholder formation
- Porter (1992): “Capital Disadvantage: America’s Failing Capital Investment System” advocated the Japanese model
- Takeaways: we want *large* investors, not *long-term* investors
 - Same remedy for engagement



Practicing Stewardship

- Define stewardship policy
 - Including divestment policy
- Embed stewardship policy. Replicable features of activists:
 - Portfolio concentration (blockholders)
 - Resources
 - Incentives
 - Freedom from conflicts of interest
- Communicate stewardship outcomes
- Applies throughout the investment chain
 - Asset owners, investment consultants