

Master Thesis Proposal

Name: B.R.M. Swaen

ANR: 741667

Subject: *Shareholder Activism by Hedge Funds in the Netherlands*

Current state of the literature

Shareholder activism is becoming more and more a hot topic in the Netherlands. A shareholder activist is an investor who buys a large stake in a publicly held corporation, with the intention to bring change and thereby realize a profit on the investment (Pound, 1992). There are numerous kinds of entrepreneurial activists, but for this thesis hedge funds are of particular interest.

There is still no generally agreed-upon definition of a hedge fund, but hedge funds are usually identified by four characteristics: they are pooled, privately organized investment vehicles; they are led by professional investment managers with performance based compensation and significant investments in the fund; they are not widely available to the public; and they operate outside of securities regulation and registration requirements (Partnoy and Thomas, 2006).

There are many examples of shareholder activism that were extensively covered in the media. A few examples are:

Orbis Fund Management, a large Océ shareholder, openly challenged the takeover bid by Canon of Océ. It stated that the takeover bid was far too low and thus significantly undervalued the Dutch company's shares (Financial Times, 2010).

Royal Dutch Shell combined its British and Dutch arms in 2004, and so ending a structure that lasted for more than a century, pressured by activist investor Knight Vinke.

Stork and Ahold both came under pressure from hedge funds Centauris Capital and Paulsen & Co. They pressured with at future break-up of the company if certain strategic actions weren't put through.

ASMI was in 2006 target of fund manager Mellon HBV, who was pushing for a split of the company (Reuters, 2007).

There is already a lot of research done about hedge funds and shareholder activism. Most often this research was aimed at looking at the short term profitability of shareholder activism. Numerous papers conclude that there is a significant positive return when shareholder activism is implanted (Klein and Zur, 2009; Brav et al., 2008). While the short term effects are of interest, Witteloostuijn (2007) argues that we still don't know much about the long term effects of

shareholder activism by hedge funds. When he mentions this he makes a comparison with private equity.

When we talk about private equity as an alternative for hedge funds, we talk about (leveraged) buy-outs. These buy-outs are transactions so that public companies are going private, often with the help of extensively use of debt.

Private equity is often misunderstood to be a sort of hedge fund. But private equity differs completely on quite a few points with hedge funds. Private equity has often a much longer investment horizon than hedge funds have. Hedge funds are often aiming for short term value creation. Also hedge funds take only a small interest in the company while private equity funds take over the whole company and commit themselves to the company for the middle long term (Eijffinger and Koedijk 2007).

Witteloostuijn (2007) made the comparison with private equity because of the fact he is interested in the difference in long term performance between the two kinds of shareholder activism. In a paper by Thomson and Pedersen (2000) there is investigated what the influence is of different corporate governance on the performance of the 435 largest European companies between 1990 and 1995. They find out that there is a relationship between the market share of the dominant shareholder and the economic performance of the company. The relationship seems to be bellshaped. Company performance is first a increasing and then a decreasing function of the ownership share of the largest owner.

If we compare this with private equity and hedge funds, the ownership share of hedge funds should then be 'too low' and the ownership share of private equity funds should be 'too high'. This is a first step in examining the long term performance of shareholder activism.

A second step could be to look at the sort of company's private equity funds and hedge funds are dealing with. There could be specific circumstances that private equity will perform better than hedge funds and vice versa. In a study by Simerly and Li (2000) they investigate the performance implications of the alignment between environmental dynamism and capital structure. With environmental dynamism they mean the degree and instability of changes in a firm's competitive environment (Child, 1972; Dess and Beard, 1984). When a company is in a very dynamic environment, having a large debt burden is often contra productive. A higher debt burden leads to a higher risk-aversion and this will constitute to lower investments in R&D, high investments in R&D are of great importance in a dynamic competitive market.

If we compare this with private equity and hedge funds, it should be true that private equity has a negative influence on the performance of a company if it is in a dynamic environment. Because of the fact that private equity funds often use a lot of debt to engage in a buy-out. So I

expect that companies in a dynamic business environment perform better under shareholder activism by hedge funds than private equity.

These two steps are helpful in thinking about the long term performance of shareholder activism. But when we compare private equity with hedge fund activism, a new problem comes up. It is extremely difficult to measure the performance of private equity, and so comparing profits between public and private equity (Boot and Cools, 2007). The most important reason is that private equity is illiquid and the profits of individual participations are often not visible.

To make this master thesis not too complex I will only look at hedge fund activism, and let go of private equity. In this master thesis I will investigate hedge fund activism of the last decade in the Netherlands, and try to examine the long term performance of hedge fund activism.

Research Question

What is the long term performance of hedge fund activism in the Netherlands, and why do some firms do better than others?

Research Plan

As formulated above, examining the long term performance of shareholder activism is very hard. So before I start with this analysis, I will first look at the magnitude of shareholder activism in the Netherlands. From the last decade I want to collect all data about public firms in the Netherlands that are or were coping with shareholder activism by hedge funds.

By doing a case based study I will be able to get a good insight of the success stories and failures of the last decade. From there on I try to establish a theory that can explain the long term performance of hedge fund activism. Because this is a difficult task I'm going to use theories from both financial theory and organizational theory.

Data Resources

- Datastream
- AFM
- <http://www.hedgefundresearch.com/>
- <http://www.hedgefund.net/>
- LexisNexis
- <http://www.hedgerelations.com/research.html>

References

- Becht, M., J. Franks, C. Mayer & S. Rossi (2009), "Returns to Shareholder Activism, Evidence from a Clinical Study of the Hermes U.K. Focus Fund", *Review of Financial Studies*, 22 (8), 3093-129.
- Boot, A.W.A. & K. Cools (2007), "Chapter 2 Private equity en activistische aandeelhouders: Bestuur onder vuur", in *Private Equity en Aandeelhoudersactivisme, Koninklijke Vereniging voor de Staathuishoudkunde Preadviezen 2007*, Eijffinger, S & C. Koedijk, Amsterdam, 15-56.
- Brav, A., W. Jiang., F. Partnoy & R. Thomas (2008), "Hedge Fund Activism, Corporate Governance, and Firm Performance", *The Journal of Finance*, 63 (4), 1729-75.
- Child, J. (1972), "Organization structure, environment, and performance: The role of strategic choice", *Sociology*, 6, 1-22.
- Dess, G. G. & D. W. Beard (1984), "Dimensions of organizational task environments", *Administrative Science Quarterly*, 29, 52-73.
- Eijffinger, S & C. Koedijk (2007), *Private Equity en Aandeelhoudersactivisme, Koninklijke Vereniging voor de Staathuishoudkunde Preadviezen 2007*, Amsterdam.
- Financial Times (2010), "Canon bid 'significantly undervalues' Océ", Harding, R. & M. Steen, <http://www.ft.com/cms/s/0/9e520efc-d413-11de-990c-00144feabdc0.html?SID=google>.
- Jong, A., G.M.H. Mertens & P.G.J. Roosenboom (2004), "Shareholders voting at general meetings: Evidence from the Netherlands", *Erasmus University Working paper*.
- Klein, A. & E. Zur (2009), "Entrepreneurial Shareholder Activism: Hedge Funds and Other Private Investors", *The Journal of Finance*, 64 (2), 187-229.
- Partnoy, F. & R. Thomas (2006), "Gap-Filling, hedge Funds, and Financial Innovation", *University of San Diego and Vanderbilt University Working paper*, Brookings Institution Press.
- Pound, J. (1992), "Raiders, targets and politics: The history and future of American corporate control", *Journal of Applied Corporate Finance*, 5 (3), 6-18.
- Reuters (2007), "FACTBOX-Cases of Dutch shareholder activism", <http://www.reuters.com/article/idUSL1925791120070920>.
- Simmerly, R.L. & M. Li (2000), "Environmental Dynamism, Capital Structure and Performance: A theoretical Integration and an Empirical Test", *Strategic Management Journal*, 21, 31-49.

Thomson, S. & T. Pedersen (2000), "Ownership structure and Economic Performance in the Largest European Companies", *Strategic Management Journal*, 21 (6), 689-705.

Witteloostuijn, A. (2007), "Chapter 5 Aandeelhoudersonrust: Een organistatiethoretische analyse", in *Private Equity en Aandeelhoudersactivisme*, Koninklijke Vereniging voor de Staathuishoudkunde Preadviezen 2007, Eijffinger, S & C. Koedijk, Amsterdam, 147-68.