Networks of large passive investors and activism

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Capital Structure of a Firm
Capital structure of the firm consists of debt and equity:
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- Equity
- Debt
Capital Structure of the Firm

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  ![Equity and Debt Pie Chart]

- Everyone who buys shares of the public firm is entitled to:
  - dividends
  - attending and voting at shareholder meetings
  - submitting a proposal at the shareholder meeting (if ownership exceeds certain percentage)
  - calling extraordinary shareholder meeting (if ownership exceeds certain percentage)
Activist Investors
Activist - an investor that purchases public company’s shares with the goal of effecting a major change in the company.
Activist Investors. Who are they?

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- A Russian activist:

В 2013 году UCPR, в которой ему принадлежит 77,7%, купила 48% «ВКонтакте» и обвинила основателя социальной сети Павла Дурова в необоснованных личных расходах и конфликте интересов из-за параллельной работы над мессенджером Telegram. Дуров в свою очередь рассказывал прессе, что новый акционер действует методом прессинга и угроз.
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• Happened this Friday, Nov. 3rd:
Activist Investors. Who are they?

Activist - an investor that purchases public company’s shares with the **goal** of effecting a **major change** in the company.

Activists are monitoring what the company is doing, and trying to fix potential inefficiencies.
Activist Investors vs. Passive Investors

Activist - an investor that purchases public company’s shares with the goal of effecting a major change in the company.

Passive investors - investors not actively engaging with the company. Example: mutual funds, index funds, etc.

Figure 1: % of total market cap held by passively managed funds.
(Source: Appel et. al 2016)
This Paper
Big Question: Why firms do what they do?

- How does shareholder monitoring affect corporate behavior?
- Emerging dynamics: more and more outsiders coming in and trying to exert changes through shareholder activism
- One extreme example: Microsoft in 2012

“When a low-profile activist investor gained a board seat at Microsoft Corp. two years ago, corporate boards around the country were stunned. How had a shareholder with less than 1% of the software giant’s stock forced its way into the boardroom?

It turns out that ValueAct Capital Management LP had some serious muscle behind the scenes ... some of Microsoft’s biggest stockholders – large mutual-fund companies not known for rocking the boat...”

(WSJ)
Smaller Question

- What does it take for an outsider activist to be able to affect change?
- Do passive shareholders (e.g., large mutual funds) play a role?
- Can we predict activists’ success based on observable measures of activist’s interactions with a network of passive investors?
Revealed preference approach
Capital Structure - in more detail

Activist
Passive Investor
Debt
Equity Structure: another way to look at it
Activist and Passive Investor are "connected" via investment portfolio
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Activist and Passive Investor are "connected" via investment portfolio.
Activist and Passive Investor link defined
Activist-Passive Investor Network constructed
Activist Attacks the Target
Conclusion
Wrapping up...

- New insight into a particular mechanism of shareholder monitoring
- Results suggest that passive investors play significant role in activists’ campaigns
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• Results suggest that passive investors play significant role in activists’ campaigns

Thank you!