Why companies with good CSR become targets of hedge fund activists

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Asset owners looking to prioritise sustainability should ensure their investments are not supporting asset management firms that undermine CSR, according to new research from Rotterdam School of Management, Erasmus University (RSM).

Activist hedge funds are becoming increasingly influential in the economy as they prioritise maximising shareholder value and focus on minimising corporate spending that they see as 'wasteful.'

However, researcher Dr Emilio Marti at Rotterdam School of Management, Erasmus University (RSM), in collaboration with Dr Mark DesJardine of Penn State University and Prof. Rodolphe Durand of HEC Paris, found that activist hedge funds are a problem for CSR.

In the United States, more than 70 of the 500 biggest companies have been targeted by hedge funds between 2011 and 2015. Hedge fund activism – when investors purchase company shares to influence the strategy and operations of a company – is also becoming increasingly important in Europe.

The business model of activist hedge funds is to target companies they deem 'wasteful' and reorient them toward maximising shareholder value in the short term. Yet activist hedge funds lack inside knowledge, so it is difficult for them to know whether companies are 'wasteful' or not. To overcome this information asymmetry, activist hedge funds will use CSR as a signal that companies are engaging in activities that activist hedge funds deem unessential to producing shareholder value, and do not maximise shareholder value in the short term.

Drawing on data covering US-based activist hedge fund campaigns between 2000 and 2016, the study found that activist hedge funds are significantly more likely to target companies with strong performance in CSR. The likelihood of being targeted nearly doubles – from 3.04 per cent to 5.11 per cent – when a company's CSR scores increase by two standard deviations above the average.

The researchers argue that activist hedge funds see CSR activities as a signal of wasteful spending that distracts companies from maximising shareholder value in the short term. Companies perceived to be wasting resources are ideal targets for activists whose business model is to generate significant profit by reorienting such companies towards maximising short-term shareholder value.

"Prior research has already shown that CSR activities drop after companies become targeted by activist hedge funds. This study reveals that strong CSR activities make it more likely that companies become targeted in the first place. Together, these insights suggest that activist hedge funds are a problem for CSR: they target companies that excel in terms of CSR – as shown in this research – and subsequently force these companies to reduce their CSR activities, as shown in prior research."

What many ordinary individuals and organisations may not realise is that their savings and assets are invested in activist hedge funds through pension funds and endowments, which have been a major driver of growth for activist hedge funds since 2009.

For more information, a copy of the research paper, or to speak with the researchers, contact Kate Mowbray at BlueSky PR on Kate@bluesky-pr.com or call +44 710022871