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Wolves at the Door: A Closer Look at Hedge-Fund Activism

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Motivation

Finance Literature: (1) Hedge fund activists target companies and push for *significant* changes. (2) These activists are relatively influential: They achieve at least one stated objective in 60-70% of cases.

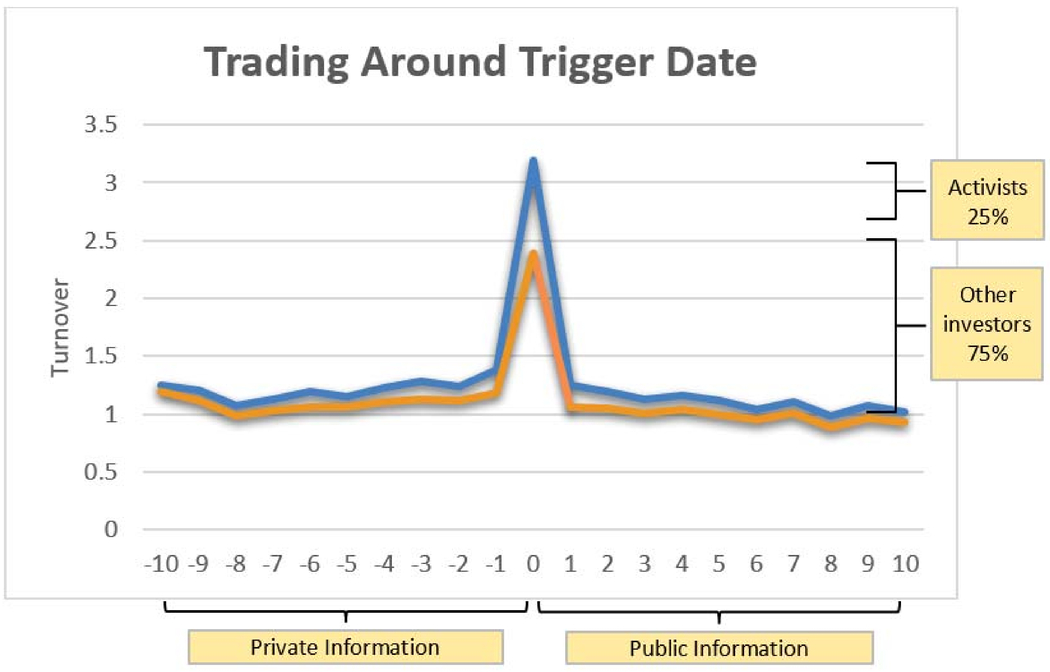
But: These activists usually hold less than 10% of the target's outstanding shares. Given low ownership, *why have activists been so successful in pressuring target firms to acquiesce to their requests*?

I examine a potential explanation for this phenomenon **"wolf pack" activism**. This theory suggests that activists are so successful because of the support offered by other investors, many of whom are thought to accumulate stakes in the target firms before the activists' campaigns are publicly disclosed.

Findings

1. There is evidence of wolf-pack formation

- My paper provides strong evidence that wolf packs are formed before the lead activist's holdings are publicly disclosed.
- I examine share turnover around the trigger date, defined as the date on which the 13D filing requirement is triggered. The trigger date is not publicly observable.
- Average share turnover on the trigger date is ***3.5 times normal trading volume.***
- After removing trades by lead activists hedge funds, the spike in turnover remains. Trade by other investors amounts to ***2.5 times normal trading volume.***



2. There is evidence that pack members coordinate

How are wolf packs formed?

Coordinated Effort: Wolf packs arise because the lead activist recruits other investors to join the campaign. The aim is to increase the % of shares controlled, without triggering adverse regulations.

There appears to be an element of coordination in the share turnover. (1) Institutions acquiring shares prior to public disclosure are more likely to be those with a prior relationship with the lead activist. (2) Wolf packs are more likely to occur in more well-defended targets.

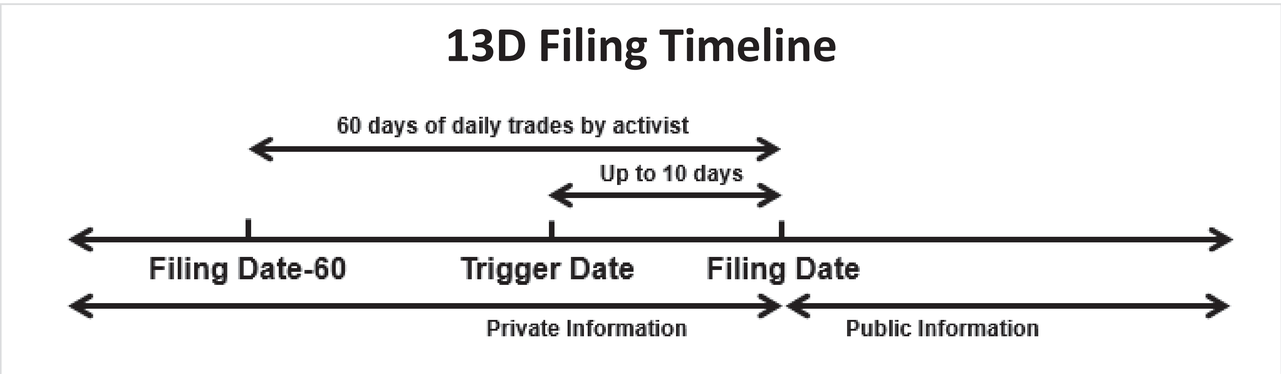
Spontaneous formation? Wolf packs may arise because of sudden changes in market conditions. For example, a sudden influx of liquidity or arrival of certain news items could trigger the same simultaneous reaction by groups of independent investors.

The abnormal trading volume cannot be fully explained by spontaneous formation. In various sub-samples where the possibility of an influx in liquidity and/or news is highly unlikely, I continue to observe a similar level of abnormally high share turnover.

3. The existence of wolf packs is associated with better outcomes for the lead activist

- Wolf-pack campaigns have a high probability of success: Future stock returns for the target firms are higher and the lead activists are more likely to obtain a greater number of board seats.

Methodology



I examine 1,922 campaigns between 1998-2014. I pull the Schedule 13D for each campaign to determine the following: (1) **Trigger date**, the date that public disclosure is triggered; (2) **number of shares traded by activists** each day during the 60-day window; and (3) **number of shares traded by other investors** on each day during the 60-day window.