CHAZEN INSTITUTE RESEARCH BRIEF

The Rise of Activist Arbitrage

KEY TAKEAWAYS

- ✓ Activist M&A arbitrage is a new phenomenon that is effectively stopping value-destroying acquisitions.
- ✓ Activist arbitrageurs advocate for modifications to M&A deals, including lowering the bid or terminating the deal if the price is too high or benefits are doubtful.
- ✓ 91 percent of deals unchallenged go through, whereas only 53 percent of deals challenged through activist M&A arbitrage succeed.
- ✓ Challenged deals often extend the duration of negotiations between the acquirer and target to approximately 186 days—nearly two additional months of negotiations.
- ✓ By blocking some deals and pushing others to be lowered, such a strategy yields significant returns for activists and acquirers.

Activist investors are increasingly setting their sights on mergers and acquisitions. Deal or no deal, these investors are confronting public companies and disrupting value-destroying acquisitions. But how does this strategy affect those companies and their M&A targets? And who wins in the end?

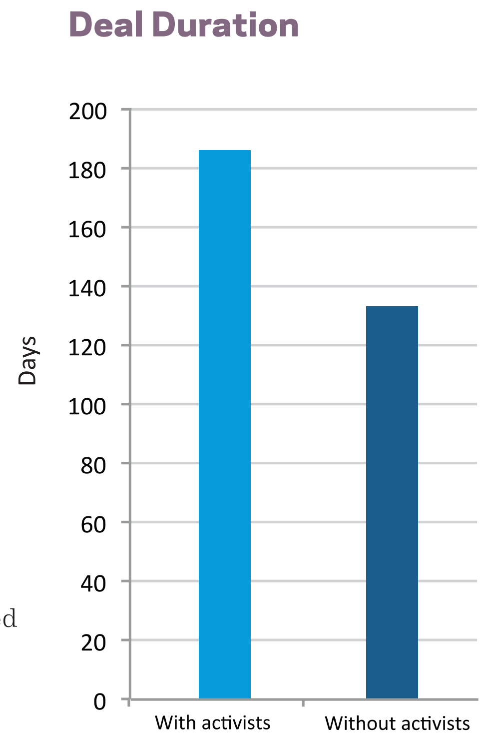
In "Activist Arbitrage in M&A Acquirers," **Wei Jiang, Chazen Senior Scholar at Columbia Business School**, Tao Li, professor at the University of Florida, and Danqing Mei, PhD student at Columbia Business School, study this new phenomenon in shareholder activism and provide evidence on how such a strategy affects target firms and activists returns.

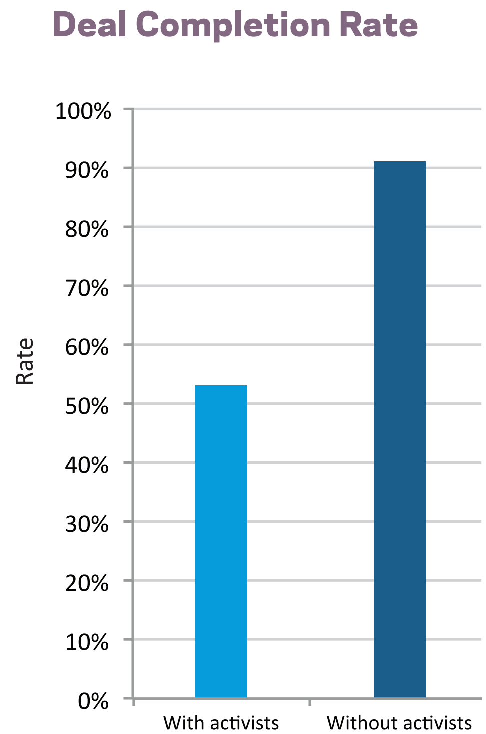
Research

This is the first study to show the impact of activist arbitrage on the acquirer's side. In an "activist M&A arbitrage," activist investors purchase shares in the acquirer after an M&A announcement has been made and exercise their right as shareholders to challenge the terms of the deal or block it altogether.

The study builds on Jiang's body of work in shareholder activism, and complements a recent paper, entitled "Influencing Control: Jawboning in Risk Arbitrage," which examines activist arbitrage on the target's side.

In a conventional risk arbitrage (also called M&A arbitrage) approach, an investor take a long position in the target and a short position in the acquirer in order to bet on the completion of the deal and to profit from the price spread convergence. In this new, unconventional risk arbitrage strategy, however, the investor takes a long position in the acquirer, aiming to upend an announced deal that is associated with low efficiency and overpayment by using his or her shareholder rights, and earns a profit from the rebound in the stock price of the acquirer.





Results

Between 2000 and 2017, the researchers found that 76 activists challenged 58 public acquirers by exercising their shareholder rights. The activists advocated for modifications to the announced deals, including lowering the bids or terminating the deal when the price was perceived as too high or the promised benefits were doubtful. The analysis shows that activists tend to target deals initiated by smaller acquirers with a history of low returns on invested capital.

Based on the researchers' sample, in 36 percent of all targeted deals, activist arbitrageurs managed to block the deal through some combination of public criticism, proxy solicitation, alternative proposals, or lobbying. In comparison, deals unimpeded by activist intervention had a 91 percent completion rate.

The negotiation process for challenged deals is often prolonged and the risk of the deal falling through is also increased. The findings reveal that if there are no challenges, the deal duration is 133 days. If a deal is challenged, then the duration extends to 186 days—nearly two additional months of negotiations.

The researchers stress that, because M&As principally benefit the target, blocking a deal can actually be a good thing for investors on the acquirer's side. If an activist-challenged deal does ultimately go through, it is often for less money than the acquirer would have paid if nobody had challenged the deal.

Acquirers with activist involvement, on average, lower their bidding premium by four percentage points, or over 10 percent of the offered premium to the targets.

Therefore, an activist M&A arbitrage strategy tends to yield significant returns and serves as a governance antidote to value-destroying acquisitions.

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