

Activist investors achieve higher returns using sell-side analysts' reports

February 10 2022, by Jeanne Hedden Gallagher



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In an era when investors can easily find information online about company performance, are traditional reports created by sell-side analysts still useful? Research from Thomas Shohfi, assistant professor in the Lally School of Management at Rensselaer Polytechnic Institute, shows that these reports are a valuable resource for activist hedge fund

investors which are some of the most sophisticated investors in the financial industry.

"Popular thinking says that sell-side analysts no longer play a role in the investment process," Shohfi said. "For [activist investors](#), we show that sell-side reports remain an important tool and that sell-side analysts should perhaps focus more time and energy on activism-related issues."

Investment banks and other securities brokerages employ sell-side analysts to conduct in-depth research on publicly traded companies and summarize their findings and insights in reports that serve as a decision-making resource for the brokerage firm's clients.

Hedge fund activists are investment firms that accumulate a large block of stock in a company, using that position to influence management and convince other large shareholders to join their cause. Activists can force changes to a firm's board of directors or alter the course of a company's business and/or financial practices in order to increase profitability. Any individual or group with an activist agenda that acquires 5 percent or more of a company's shares must file a Schedule 13D with the Securities and Exchange Commission (SEC).

Shohfi used these two complex data sources, the analysts' reports and the SEC Schedule 13D filings, to examine sell-side information production relative to hedge fund activists. He found that sell-side reports contain more activist-related language and more quantitative information months before 13D filings are released.

Shohfi's research also showed that a higher ratio of increased use of activist vocabulary in sell-side analyst reports relative to 13D filings was associated with greater stock returns after hedge fund activists announced their ownership.

"Sell-side analysts are indirectly contributing to this increase in shareholder value because activist hedge funds see them as a source of idea validation and reinforcing the fund's internal information production," Shohfi said.

The study also found that nearly one-third of publicly available letters written by activists to other shareholders, boards of directors, and management following the 13D filings mention specific information used in the sell-side analysis reports.

"If activist hedge funds are directly referencing research from these sell-side analysts in their letters, it's clear that they believe sell-side analysis still has value. Arguments and proposals in letters backed by sell-side analysis help activist hedge funds capture higher returns for firm shareholders," Shohfi said. "Sell-side analysts continue to play a role in corporate governance."

To conduct the review, Shohfi first used textual analysis to develop a dictionary for activism tactics and objectives, a key technique used throughout Shohfi's core body of research using alternative data as a source of untapped information.

More information: Huimin (Amy) Chen et al, Do Sell-Side Analysts Play a Role in Hedge Fund Activism? Evidence from Textual Analysis, *Contemporary Accounting Research* (2022). [DOI: 10.1111/1911-3846.12760](https://doi.org/10.1111/1911-3846.12760)

Provided by Rensselaer Polytechnic Institute

Citation: Activist investors achieve higher returns using sell-side analysts' reports (2022, February 10) retrieved 1 February 2023 from <https://phys.org/news/2022-02-activist-investors->

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