San Francisco-based Hedge Fund Manager & Expert Witness Brings Real-World Skills to Students

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Marty Dirks is a San Francisco-based Litigation Consultant and Expert Witness who is an expert in hedge fund strategies, securities selection, and portfolio management. He has provided investment consulting, investment research and expert witness services to investment funds and law firms at his own firm, Investment Strategy & Analysis, since 2004. Dirks researched fraud and misrepresentation by publicly traded companies as a short seller for over ten years. Dirks is a board member for the San Jose City pension plan, which manages total assets of $5 billion. For more than ten years, he managed stock portfolios, including the Harvard endowment's technology stock portfolio, which grew from $110 to $870 million during the 5 ½ years he managed it. He has been an adjunct professor of finance at Golden Gate University since 2006 and currently teaches Portfolio Management — the advanced investments course for the MBA and Master's Degree in Finance programs.

Please tell us about your expert witness work.

The kinds of cases I work on usually have to do with business valuation and the calculation of damages. However, the facts of the case vary tremendously. I have been asked for opinions on widely varying topics. For example:

"When an employee left and started their own investment firm, did they inappropriately take trade secrets? Or, did they just learn skills to manage investments which they are applying in their new venture?"

"A sales/marketing person raised money for an investment fund that turned out to be a fraudulent Ponzi scheme. Did they know there was fraud? Should they have known there was fraud? Are they guilty of a crime?"

"A promising tech startup, the leader in its segment, had its business interrupted for eighteen months. During that time, when they were unable to move forward, a new competitor raised money and now is the market leader. What is the business worth now? What would the business be worth if it had never been interrupted?"

As an expert, I am presenting my impartial and unbiased professional opinion based on the facts of the case. I am not an advocate for the client. It is the attorney's role to argue for their client's position, not mine. I provide expert opinions for both plaintiffs and defendants.

I love expert witness work because every case is like a new chapter in my life. Each case has unique facts I use to form my opinions. Then, a settlement is made, or a legal decision is made, the case is over, and it is time to move on to the next chapter.

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What from your expert witness consulting do you bring to classes?

The expert witness work covers very diverse situations. It’s real. It’s case specific. Legal cases provide an opportunity to bring a slightly messy situation, just like most real situations are, in for discussion. Textbook problems are very “clean,” but unrealistic.

The situations I like to bring to the classroom cover the same concepts as the textbook but have something commonly seen in the real world which is the unexpected. Students become more comfortable with the unexpected – like fraudulent activity or market prices that are sometimes wrong – and that prepares them to address challenges they will face in the workplace.

In the class I teach, I try to address the question, “How does the financial world work and why does it work that way?” That overlaps with my experience in court, as a traditional investor and as a short-seller. It’s not a highly quantitative class. I focus on how to determine the important questions to answer; that’s the difficult part.

What do you teach students that comes directly from your investment career experience?

I was a short seller for more than a decade. I often looked for companies which had accounting fraud. The signs of accounting fraud are not usually taught in an investment course. However, if you invested in Enron, or some other company that was a disaster for investors due to fraud, you certainly would wish you knew something about that.

One of the most common fraudulent activities that shows up in accounting is when a company gives away its product to boost its reported profit. It works this way: If the CEO of a public company misses their business forecasts, their job is at risk.

It’s a very big deal. They will do almost anything to “make their numbers.”


Marty Dirks in front of Golden Gate University, downtown San Francisco

They may think: “Sales are not going to meet my forecast, so I am just going to ship some products to customers at the end of the quarter. Once it leaves the shipping dock, I can count it as revenue, and it will contribute to profits.” However, the customer never ordered it and probably won’t pay for it. You might as well say, “they gave the product away.”

What shows up in the reported financials is that sales have gone up, but the cash balance has not gone up to reflect those sales. It looks like the products were given away, which essentially they were.

Being an investor and looking at how companies compete, succeed and fail for years was an amazing education. As an investment manager, you may have hundreds of millions of dollars invested and at risk every day, so you must take it very seriously.

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Is there a particular concept that is important in the class you teach?

A relatively simple concept I cover in detail is Enterprise Value. Consider a company that is trading at $18 per share, has $10 per share in cash and no debt. If the market falls hard and I can buy the stock for $12 per share, I am only paying $2 per share for the company. $2 per share is the value for the business, the Enterprise Value. The other $10 per share is in cash. If I am looking for attractive investments in a market downturn, I want to use that idea.

The concept of Enterprise Value may be clearer if we consider a more familiar situation. If I write a check for $500,000 to buy a house and assume a mortgage for $500,000, what did I pay for the house? I only wrote a check for $500,000, but we would all understand the house is being valued at $1 million. $1 million is the Enterprise Value.

I cover financial theory and discuss both where the theory is valid and where it falls down. I tell students that if in the next three years something I have taught them has not been valuable to them, I have failed. And, I hate to fail!

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Going beyond concepts and applications, can you talk about companies, their leadership, strategy, and so on?

In the technology industry, industry leaders tend to remain leaders. For a technology business, the largest business expense is the cost to develop the technology. All competitors must incur a similar level of cost to develop a similar product.

The industry leader has more customers and sells more units. The technology development costs are spread over more units, and profit per unit sold is higher for the leader than competitors. This provides the leader with greater resources to develop better products and, over a short time, usually the leader's product offering is far superior and even priced lower. This superior product advantage is usually sustained and competitors fall further and further behind. Venture capital investors are willing to pay a large premium for market leaders, betting that they will sustain their leadership position.

The proof of this winner-takes-all theory is clear when you think about the most successful tech companies. Consider Amazon (online retail), Cisco Systems (computer networking), eBay (online resale), Facebook (social networks), Google (internet search advertising), Microsoft (PC software), Oracle (databases). The theory does not work in every case, but in most cases it does.

Corporate leadership is critical. It’s also difficult for an investor to assess. It also takes many years to form any judgments. Investors usually interact with corporate leaders when they are in a public setting and on their best behavior. I would rather see them in their darkest hours. Then, I know them better and can form a judgment about what they do best and what challenges are most difficult for them. As an institutional investor, you can get to know managers personally, and you will talk with them candidly as they go through challenging times.

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Founded in 1901, Golden Gate University is a private, non-profit institution specializing in educating professionals through its schools of law, business, taxation, and accounting.

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