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The Evolution of Shareholder Activism in the United States*

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Shareholder activism in the U.S. is by no means a new phenomenon. In the early 1900s, American financial institutions such as insurance companies, mutual funds, and banks were active participants in U.S. corporate governance. In many cases, the representatives of such institutions—among them J.P. Morgan and his associates—served on corporate boards and played major roles in the strategic direction of the firm.

But over the next three or four decades, laws passed with the aim of limiting the power of financial intermediaries also prevented them from having an active role in corporate governance. [1] The Glass Steagall Act prohibited U.S. banks from owning equity directly. And the regulatory reforms that followed the stock market crash of 1929 limited the liquidity of, and otherwise raised the costs to, investors of active participation in corporate affairs. The consequence of such laws and regulations was a progressive widening of the gap between ownership and control in large U.S. public companies—a process that continued until the emergence of corporate raiders and LBOs in the 1980s.[2]

The current wave of U.S. shareholder activism can be seen as dating from the SEC's introduction in 1942 of a rule (the predecessor of today's rule 14a-8) that first allowed shareholders to submit proposals for inclusion on corporate ballots. Since that time, the identities of shareholder activists have changed along with the focus of their efforts to bring about change. From 1942 through the end of the 1970s, shareholder activism was dominated by individual investors. The 1980s, by contrast, saw an increase in the involvement of institutional investors, at first mainly public pension funds. These pension funds submitted shareholder proposals, pressured management "behind-the-scenes" for corporate reforms, and used the press to target the management and boards of poorly governed or performing companies. The 1980s also saw the rise of corporate raiders—perhaps the ultimate activists—who used the market for corporate control to try to impose discipline on boards and managements.

But with the decline of the takeover market during the 1990s, and regulatory changes that enhanced the ability of shareholders to communicate on voting issues, activist institutional investors again came to the fore. At the same time, labor union pension funds began to assume a major role in investor activism. Indeed, as discussed later, a number of innovations in the use of shareholder proposals can be attributed to union-based funds.

While these different varieties of activism can still be seen today, the evolutionary process continues. In particular, during the past few years, hedge funds and private equity funds have assumed prominence in the activist arena. These funds have become increasingly important players in financial markets, particularly in their capacity as monitors of corporate performance and agents of change. In many respects, the hedge funds that take large, relatively long-term positions in underperforming companies (and, contrary to popular perception, there are a significant number of such funds) can be viewed as the modern-day equivalent of the active investors who disciplined U.S. managers at the turn of the last century.

In the pages that follow, we review the evolution of shareholder activism since the establishment of the SEC in the 1930s, with emphasis on three main subjects: the kinds of companies that are targeted by activists; the motives of institutional investors for activism; and the effectiveness of activists in bringing about economically significant change at targeted companies. We finish with an analysis of the most recent changes that have occurred with the entry of hedge funds into shareholder activism.[3]

Varieties of Shareholder Activism

Shareholder activists are often viewed as investors who, dissatisfied with some aspect of a company's management or operations, try to bring about change within the company without a change in control. But one can also think of shareholder activism more broadly as encompassing a continuum of possible responses to corporate performance

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* We dedicate this paper to the memory of B. Kenneth (Ken) West.

1. See Roe (1990). Full citations of all articles appear in the References section at the end of the paper.
2. See Bhide (1990, 1993).
3. For previous surveys of shareholder activism, see Black (1998), Gillan and Starks (1998), Karpoff (2001), and Romano (2000). Partnoy and Thomas (2006) contrast shareholder activism by hedge funds and institutional investors.

and activities. At one end, we could view shareholders who simply trade a company's shares as being "active." Through their initial purchases and subsequent decisions to hold or sell, shareholders are expressing their views of the corporation's performance. At the other end of the continuum is the market for corporate control, where investors initiate takeovers and LBOs aimed at accomplishing fundamental corporate changes. Between these extremes are intermediate points on the continuum that include, for example, blockholders who purchase minority stakes with the intent of influencing managerial decision-making.

Dissatisfied shareholders can simply vote with their feet—a practice known as "the Wall Street walk"—by selling their shares. And theoretical and empirical studies provide evidence that the act of selling shares can have disciplinary effects on companies that lead to changes in governance.[4] For example, the probabilities of CEOs being fired and replaced by executives from outside the firm are higher after large sell-offs by institutional investors. Dissatisfied shareholders who choose instead to hold their shares (perhaps because they are "indexed" and so unable to sell) have two choices: (1) do nothing (and thereby exhibit "loyalty") or (2) express their dissatisfaction using some means ranged on the continuum discussed above.[5] Our primary interest in this article is in the variety of ways that shareholders have "voiced" their dissatisfaction with managements and boards over the past six decades and how both the identity of the shareholders and the focus of their dissatisfaction have changed.[6]

A Short History of Shareholder Activism

In 1942, after a series of new laws and regulations forced active investors out of corporate governance, the SEC adopted a rule that was the predecessor of and paved the way for the current rule 14a-8, which states that management must allow shareholder proposals that constitute a "proper subject for action by the security holders." In 1943, shareholders began to submit proposals aimed at improving corporate governance and performance. And the next three decades saw a flood of shareholder resolutions aimed at improving performance and raising share values.

But that was not the only intent of such proposals. In 1970 a federal court decision allowed a shareholder proposal to forbid the sale of napalm by Dow Chemical, and other proposals on social responsibility issues began to appear.[7] To get a sense of the proportion of shareholder proposals devoted to social issues at this time, consider that the member companies of the American Society of Corporate Secretaries reported that 611 of the 790 proposals they received during the 1978 proxy season dealt with governance issues and the other 179 with social issues. As for the disposition of these 790 proposals, 439 were voted on, 197 were excluded from the proxy statements, 125 were withdrawn, and the fate of the remaining 29 is unknown.[8]

Until the mid-1980s, the major proponents of shareholder proposals were individuals that came to be called "gadfly" investors.[9] For example, in 1982, almost 30% of the 972 resolutions submitted to 358 companies came from three individuals: Lewis and John Gilbert, and Evelyn Davis.[10]

Starting in the mid-1980s, however, shareholder activists began to work in numbers, and a number of groups have arisen—and some met their demise. For example, T. Boone Pickens established the United Shareholders Association (USA) in 1986 with the expressed intent of "upgrading shareholder awareness." After monitoring and targeting corporations and submitting corporate governance shareholder proposals for seven years, the group's board voted to disband in 1993.[11] Another coalition of individual shareholders, the Investors' Rights Association of America (IRAA), began submitting proposals in 1995 and did so for a short time.

Perhaps the newest group of prominent shareholder activists, known as The Investors for Director Accountability, was organized in March of 2006. Headed by luminaries that include John Bogle, T. Boone Pickens, and Robert Monks, the group has declared its goal to be the restoration of directors' accountability to shareholders.[12]

The Growing Role of Institutional Investors. With the suspension of hostile takeovers at the end of the 1980s, and the steady growth in their ownership of U.S. companies, U.S. institutional investors were forced to play a more active role in corporate governance. As can be seen in Figure 1, institutional investors held only about 10% of U.S. equities in 1953, but their percentage ownership had jumped to over 70% by the end of 2006.

The beginnings of shareholder activism by institutional investors can be identified in the formation, in 1985, of the Council of Institutional Investors, which was led by Jesse Unruh, then treasurer of the state of California. As state treasurer, Unruh was responsible for the performance of two large institutional investment funds, the California Public

4. For analyses of the effects of selling shares on corporate governance, see Admati and Pfleiderer (2006) or Parrino, Sias, and Starks (2003).

5. Hirschman (1971).

6. Our focus in this review is on studies of corporate governance issues and attempts to link governance-based activism to shareholder value. This is notably different from the intent of, say, Tkac (2006), which provides an analysis of shareholder proposals with particular focus on social issues.

7. Manne (1972).

8. American Society of Corporate Secretaries, 1979, *Report on Shareholder Proposals July 1, 1978 to June 30 1979.*

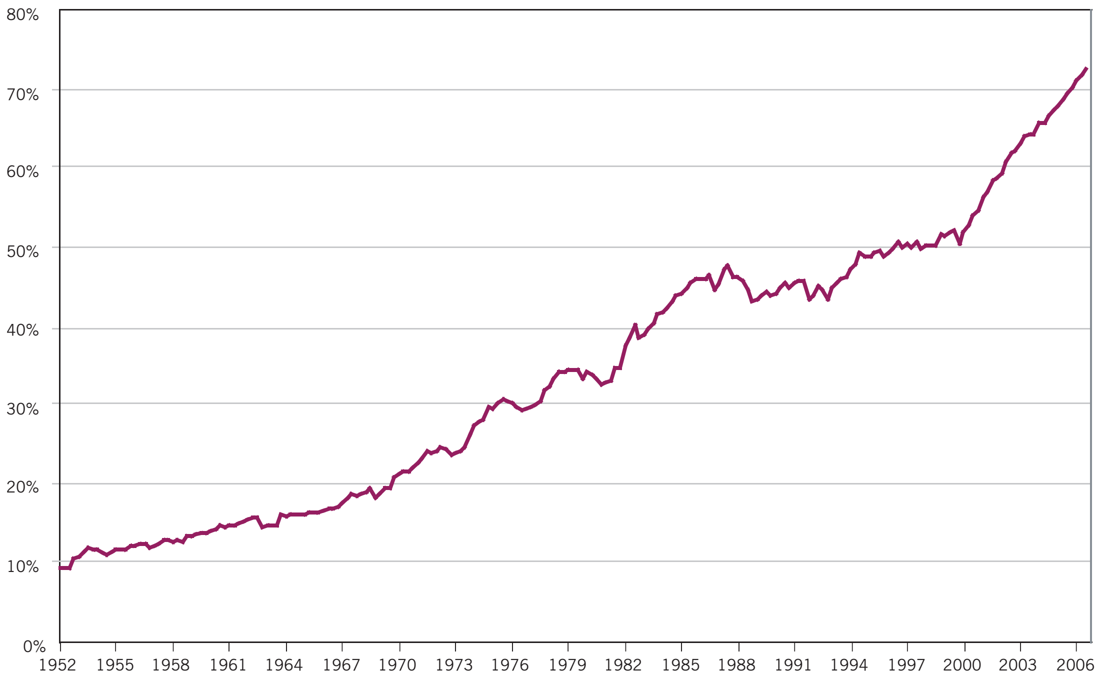
9. Some of the gadflies had been submitting proposals since they were first allowed in 1942. In fact, according to Talner (1983), the activism of the Gilbert Brothers can be traced to a 1932 annual shareholders meeting of Consolidated Gas in which the Chairman never recognized any of the shareholders who had raised their hand to ask questions. Lewis Gilbert was reportedly appalled by the lack of communication between management and shareholders.

10. Ross, N., 1983, "Gadflies Set to Buzz Shareholders' Meetings," *The Washington Post* (April 17), G1.

11. See Strickland, Wiles, and Zenner (1996) and Speeches of T. Boone Pickens http://digital.library.okstate.edu/Pickens/1988/062488A2.html

12. Tiffany Kary, 2006, "Upstart Investors for Director Accountability Target Pfizer," Marketwatch.com.

Figure 1 **Percentage Ownership of Institutional Investors in U.S. Stock Markets**



Employees Retirement System (CalPERS) and the California State Teachers Retirement System (CalSTRS). Both of these funds were heavily invested in Texaco. Unruh formed the Council in response to learning that the Bass Brothers, after acquiring a 9.8% block in Texaco, sold the shares back to Texaco at a $137 million premium over the current market price—a repurchase offer that was not extended to other shareholders like CalPERS and CalSTRS. The purpose of the Council of Institutional Investors was to act as a lobbying group for shareholder rights.[13]

Still in existence today, the Council has evolved to the point of becoming a focal point for many institutional shareholder activists. Although started as an organization primarily for public pension funds, it now consists of more than 140 public, labor, and corporate pension funds that control in excess of $3 trillion in financial assets. Its stated objective is to enable institutional investors to pool their resources and "use their proxy votes, shareowner resolutions, pressure on regulators, discussions with companies, and, when necessary, litigation to protect plan assets."[14]

Such institutional activism expanded greatly in 1986 and 1987, as large public pension funds began to submit shareholder proxy proposals, both individually and in collaboration with one another. In our own study of proposals by institutional investors during the 1980s and 1990s,[15] we found that the three most common objectives of such proposals were the repeal of antitakeover amendments, the adoption of cumulative voting, and greater board independence. But, as we also discovered, public pension funds changed their approach to activism in the early 1990s. One important change was to submit fewer proxy proposals while trying harder to initiate a dialogue with targeted companies' managements and boards. Another was to make greater use of the media in targeting companies, while alerting other investors to the firm's problems and the activist's proposals.

Until the recent emergence of hedge funds, the most activist institutional investors have been public pension funds and union funds. In the mid-1990s, union funds began to account for a larger proportion of shareholder proposals while the public pension funds' share started to fall. But their labor affiliation notwithstanding, the goals of the union funds have been similar to those of other institutional investors. As Stuart Schwab and Randall Thomas commented in a 1998 *Michigan Law Review* article, "In most cases it is hard to find a socialist or proletarian plot in what unions are doing with their shares. Rather labor activism is a model for any large institutional investor." And since publication of this article, the union funds appear to have persisted in this behavior. Besides submitting shareholder proposals, the unions have pursued innovative forms of activism, not only in terms of developing new proposals, but also by using the media to pressure management (the

13. See Monks and Minow (2003).
14. Council of Institutional Investors website, 2006; www.cii.org.
15. Gillan and Starks (2000).

Teamsters publicly target individual directors rather than just a particular company), and making proposals from the floor at annual meetings.[16]

Along with the rise of institutional investor activism in the mid-80s, the Department of Labor, through its oversight of ERISA portfolios, began to pressure corporate pension funds to assume a more active role in monitoring the companies in their portfolios. They advocated the voting of proxies by the pension funds rather than delegating that responsibility to their external managers, arguing that voting was part of their fiduciary duty.[17]

Although private pension funds and mutual funds did not generally participate in public shareholder activism, money managers purportedly played a major role in the ouster of some high-profile CEOs. For example, according to *Pensions and Investments*, the removal of James D. Robinson as chairman of American Express was the result of pressure by private money managers, not public pension funds. And Fidelity reportedly had a behind-the-scenes role in Kay Whitmore's departure as the CEO of Eastman Kodak.[18] Money managers have been involved in other types of activism as well. For example, in 2002, Fidelity announced that it would vote against directors if executive compensation was not sufficiently linked to corporate performance. And in that same year, Fidelity took private activism further by appointing one of its own executives, Steve Akin, as chief executive of Colt Telecom, the troubled U.S. telecommunications group.

While the efficacy of institutional activism continues to be the subject of debate, these activists achieved a considerable measure of influence. As one observer noted in 1996, "Fifteen years ago, the CEO and CFO did not know major holders and really didn't care. CEOs are now more accessible to money managers."[19]

Motives for Shareholder Activism

Shareholder activism is, at bottom, a response to the potential gains from addressing the agency conflict at the core of large publicly traded companies with absentee owners. In such companies, shareholders effectively delegate decision-making responsibility to managers whose interests can diverge from those of their shareholders.[20] The board of directors has a significant role in controlling such agency problems that comes with its fiduciary obligation to shareholders, which includes the responsibility to hire, fire, compensate, and monitor top management. The demand for activism arises when boards fail to perform these tasks.

There are a number of remedies for inadequate boards, starting with the fact that common stocks are bought and sold in a marketplace.[21] Precisely because investors can sell their shares to the highest bidder, there is a market for corporate takeovers—or, in academic parlance, a "market for corporate control"—that gives competing management teams, as well as unaffiliated active investors, the ability to gain control of companies, thereby circumventing ineffective managers and boards. But even in cases where there appear to be no bidders, the stock market performs an inherent monitoring function that exerts pressure on managers and boards to make decisions that serve the interests of shareholders. As Bengt Holmstrom and Jean Tirole have argued, the stock market may be the most reliable monitor of managerial performance because stock prices incorporate a variety of kinds of information about future performance and value that cannot be found in financial statements alone.[22]

We now have substantial theoretical and empirical evidence that documents the monitoring role played by institutional investors.[23,24] When interpreting such evidence, however, it's important to recognize that such investors differ in terms of their trading styles, incentives for managers, clienteles, legal and regulatory environments, and ability to gather and process information. These differences in turn imply differences among institutions' motives and capabilities for monitoring—and the evidence supports this contention. For example, empirical studies suggest that the presence of certain kinds of institutional shareholders in a company's ownership base influences (and is often influenced by) its executive compensation policy, its operating performance, and the market for corporate control that surrounds it. For example, companies with disproportionate holdings by independent investment advisers and mutual funds tend to place greater emphasis on pay for performance, produce consistently higher returns on capital, and avoid value-reducing mergers.[25]

16. Prevost, Rao, and Williams (2006) and Schwab and Thomas (1998).

17. The 1994 release of the Department of Labor's Interpretative Bulletin 94-2 (IB 94-2) took an even stronger stance on the responsibility of corporate pension funds by stating that, "…active monitoring and communication with corporate management is consistent with a fiduciary's obligations under ERISA where the responsible fiduciary concludes that there is a reasonable chance that such activities…are likely to enhance the value of the plan's involvement, after taking into account the costs involved."

18. See *Pensions and Investments*, 1993, "The Value of Activism" (February 22), 12 and Myerson, A., 1993, "Wall Street, the New Activism at Fidelity," *New York Times* (August 8), Section 3, 15.

19. Ettorre (1996).

20. Jensen and Meckling (1976).

21. Eugene Fama and Michael Jensen suggest that the unrestricted nature of common stock residual claims allow special market and organizational mechanisms for controlling these problems (Fama and Jensen (1983)).

22. Holmstrom and Tirole (1993).

23. Examples include Agrawal and Mandelker (1992), Almazan and Suarez (2003), Black (1992), Del Guercio and Hawkins (1999), Gillan and Starks (2000), Hartzell and Starks (2003), Kahn and Winton (1998), Kaplan and Minton (1994), and Noe (2002).

24. There is also a broad literature examining the role of shareholders in general, for example, Admati, Pfleider, and Zechner (1994), Black (1990), Bolton and von Thadden (1998), Chidambaran and John (1998), Coffee (1991), Huddart (1993), Maug (1998), Maug and Rydqvist (2006), Noe (2002), and Shleifer and Vishny (1986), amongst others.

25. Almazan, Hartzell, and Starks (2005), Borokhovich, Brunarski, Harman,and Parrino (2006), Brickley, Lease and Smith (1988), Bushee (1998, 2001), Chen, Li, Harford (2006), Cornett, Marcus, Tehranian (2004), Gaspar, Massa, Matos (2005), Pinkowitz (2003), and Qiu (2005).

Table 1 **Number of Corporate Governance Proposals Submitted over Two Separate Periods**

Major Issues	1987-1994	2001-2005
Repeal classified board	314	199
Eliminate poison pill	249	220
Cumulative voting	274	93
Supermajority	21	47
Audit-related	19	62
Board-related	279	353
Executive compensation	233	573
Other	653	183
Total	2042	1730

On the other hand, institutional investors, such as corporate pension funds or insurance companies, may be reluctant to undertake activism against other corporations, particularly those with which the sponsoring company does business. Because of business relations with the corporation, some institutional investors may feel compelled to vote with management even though such behavior runs contrary to their fiduciary interests. [26]

Consistent with the idea that institutional investors may face potential conflicts of interest in monitoring companies, a study by Roberta Romano investigated a widely held hypothesis that public pension funds are more effective monitors of management because they vote their own shares, whereas private pension funds typically delegate their voting to external money managers. However, she found no evidence to support this hypothesis. Furthermore, according to a survey of institutional investors from the IRRC, there has been no significant difference in voting policy between public and private pension funds: both groups tended to support management over the survey period.[27]

A 1993 survey of the 40 largest U.S. pension funds, 40 of the largest investment managers, and 20 largest charitable foundations reported finding major differences among institutions—even institutions of the same type—in their attitudes and approaches to shareholder activism. For example, although we might expect to find indexed portfolios more engaged in activism, the survey indicated that while some index fund managers were highly active, most were completely passive. Based on follow-up interviews, the authors of the survey also reported that activist institutions preferred direct negotiation to proxy proposals, in large part because of the difficulty of persuading other institutions to agree on unified proxy strategies. Besides the need for arduous coalition-building among investors, another reason for avoiding proxy campaigns—at least prior to 1993—was regulatory constraints on communication among investors.[28]

Although some public pension funds have been praised for their advocacy of shareholder interests, a number of studies have shown that the incentives of the decision-makers at public pension funds may not be consistent with value-increasing shareholder activism.[29] A 2002 study comparing the relative value of companies held by public and private pension funds reported that corporate values were positively related to private pension fund ownership and negatively related to (activist) public pension ownership. In attempting to explain this finding, the author focused on political and social influences on public pension fund managers that divert their focus from maximizing value.[30]

Some legal scholars have even suggested that the costs of shareholder activism are likely to exceed the benefits, and that the SEC should accordingly consider raising the hurdles for submitting shareholder proposals.[31] In a similar spirit, others have argued that activist institutions often pursue narrow agendas that, rather than aimed at increasing value, have the potential to undermine the effectiveness of corporate boards.[32]

What Companies Get Targeted?

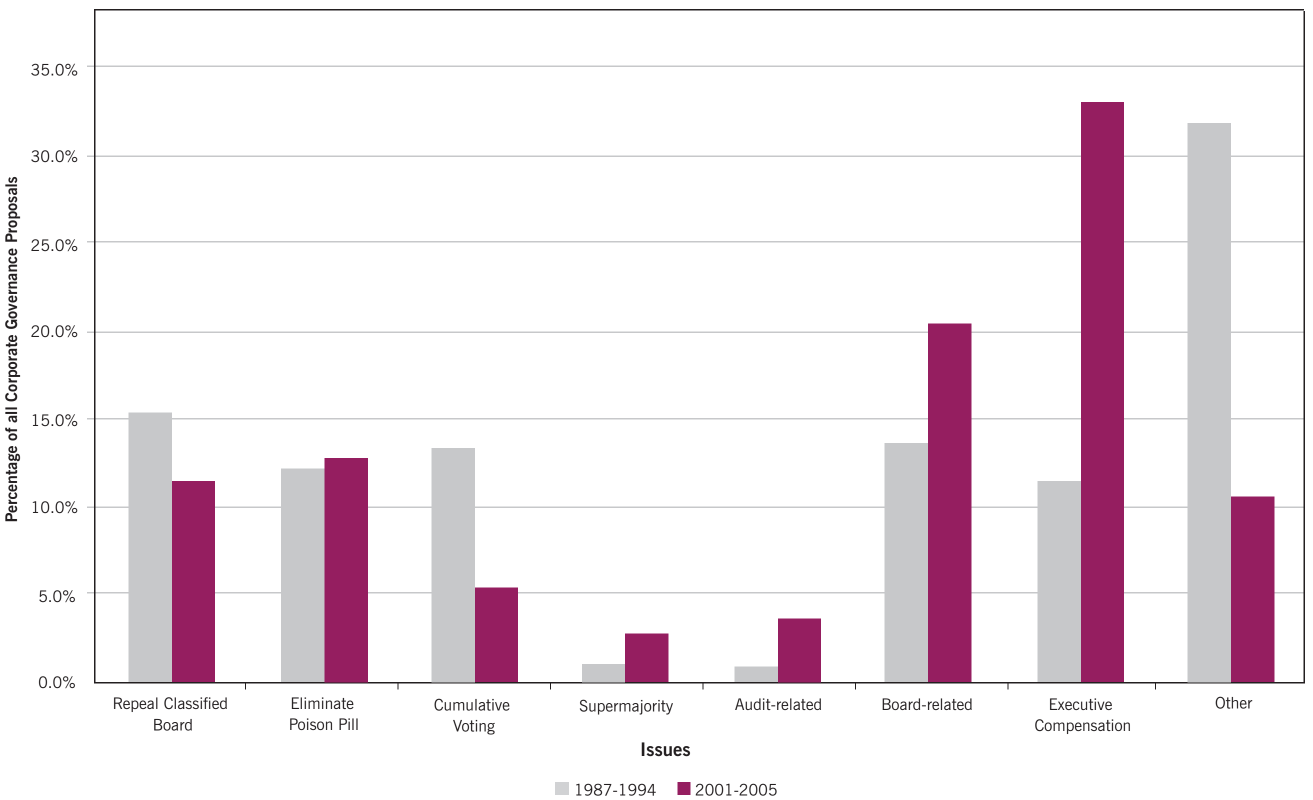
Until recently, the main criterion for the targeting of a corporation by shareholder activists has been poor performance. The targets have also often been characterized by large shareholdings by other institutional investors, low inside ownership, and what investors perceive to be a poor governance structure.[33] Although some of the early targeting by public pension funds and TIAA-CREF focused primarily on companies with questionable governance structures, that practice largely disappeared in the early 1990s. For example, CalPERS, after experimenting with a variety of indicators of substandard governance, settled on poor performance as its primary criterion for targeting in 1990.[34] While in some cases poor performance and poor governance still trigger activist campaigns, recent hedge fund activism has rekindled the focus on profitable companies.[35]

The Evolution of Shareholder Proposals: Issues and Sponsors

The findings of our own (previously cited) study of corporate governance shareholder proposals submitted during the period 1987-1994, when set against the findings of a later study by the proxy firm Georgeson for the period 2001-2005, allows us to see the main issues of interest to shareholder activists and

26. Brickley, Lease, and Smith (1988) and Pound (1988).
27. Romano (1993).
28. Bradley, Brav, Goldstein, and Jiang (2006) and Useem, Bowman, Myatt, and Irvine (1993).
29. Murphy and Van Nuys (1994) and Woidtke, Bierman, and Tuggle (2003).
30. Woidtke (2002).
31. Romano (2000).
32. Bainbridge (2005).
33. Carleton, Nelson and Weisbach (1998), Huson, (1997), John and Klein (1995), Karpoff, Malatesta, and Walkling (1996) and Smith (1996).
34. Thomas and Cotter (2006).
35. Brav, Jiang, Partnoy, and Thomas (2006) and Klein and Zur (2006).

Figure 2 **Corporate Governance Proposal Issues Across Two Periods**



how they have changed over time.[36] As can be seen in both Table 1 and Figure 2, both periods saw extensive efforts by activist shareholders to remove poison pills, classified boards, and supermajority antitakeover amendments from corporate charters. Concerns about board independence and executive pay, while certainly in evidence in the earlier period (accounting for 13.7% and 11.4%, respectively, of all proposals), became much more prevalent in the later period (at 20.4% and 33.1%). And while the general focus of some of the proposals remained unchanged, there were also notable changes. For example, in the earlier period, the two most common board-related proposals aimed at increasing director share ownership and limiting directors' terms. During the more recent period, the two most common board-related proposals were aimed at achieving director elections through majority vote and independent board chairmen.

Figure 3 shows that there were also large changes in the sponsors of the corporate governance proposals between the two periods. Union funds became a much larger force in shareholder activism, submitting over 40% of the proposals in 2004 and 2005, as compared to less than 10% during the 1987-1994 period. In contrast, public pension funds accounted for a much smaller share of proposals (4%, as compared to an earlier 14.2%), as did unaffiliated individuals (44.5%, as compared to an earlier 70.4%).

Does Shareholder Activism Work?

Measuring the effectiveness of shareholder activism is a difficult task for several reasons. First, identifying cases of shareholder activism can be problematic. For example, when activists negotiate behind the scenes, there may be no external sign of the activity. Take the case of CalPERS and Texaco cited earlier. CalPERS submitted a shareholder proposal to the company calling for the creation of an advisory committee of major shareholders to work with management. After directly negotiating with Texaco and getting an agreement that management would nominate a pro-shareholder candidate to its board of directors, CalPERS withdrew its proposal.[37] Such activities are not detected by most studies of shareholder activism.

36. Data for the early period come from Gillan and Starks (2000). Data for the latter period come from Georgeson Shareholders' 2005 Annual Corporate Governance Review.

37. Parker, M., 1989, "It's Almost Spring, and That Means Proxy Fever," *New York Times* (March 5), Section 3, 8.

Table 2 **Empirical Studies of Shareholder Activism**

This table shows by study the sample period, the type of activism examined, the sponsors examined, the number of firms and activism events and the overall conclusions regarding outcomes.

Study	Sample Period	Type of Activism	Sponsor of Activism	Number of Firms and Activism Events	Conclusions Regarding Outcomes
Gordon and Pound (1993)	1990	Governance proposals	All sponsors	266 proposals	Voting outcomes depend on governance and performance of target firm and ownership by insiders, institutions, ESOPS and blockholders.
Nesbitt (1994)	1987-1992	All governance activism	CalPERS	42 firms	Targeted companies underperformed S&P 500 by 66% in five years before targeting and outperformed by 41% in five years after targeting.
Gillan (1995)	1986-1991	Governance proposals	All sponsors	1019 proposals at 305 firms	While there is a positive stock market reaction to shareholder proposals in some subsamples, on average there is no improvement in long-term stock market performance or operating performance. Public pension fund sponsorship of shareholder proposals is positively associated with the percentage of votes received.
John and Klein (1995)	1991-1992	Social and governance proposals	All sponsors	344 proposals	The likelihood of a firm being the target of corporate governance proposals is significantly affected by firm size, presence of negative net income, percentage of outside directors with outside directorships in other S&P 500 firms, the percentage of institutional ownership and whether or not shareholders vote on the choice of auditor and last year's vote.
Karpoff, Malatesta and Walkling (1996)	1986-1990	Governance proposals	All sponsors	522 proposals at 269 firms	There is no persuasive evidence that shareholder proposals increase firm values, improve operating performance, or influence firm policies.
Smith, D.G. (1996)	1990-1995	Activism aimed at Kmart	All sponsors	1 firm	Concludes that problems were due to managerial incompetence and that shareholder activism is an ineffective mechanism for dealing with this type of problem.
Smith, M. (1996)	1987-1993	All governance activism	CalPERS	51 firms	Shareholder wealth increased for firms that settled with CalPERS and decreased for firms that resisted. There were no statistically significant changes in operating performance.
Strickland, Wiles, and Zenner (1996)	1986-1993	Proposals and negotiated settlements	United Shareholders Association	216 proposals at 85 firms	Votes on proposals were higher when target had poor performance and more institutional investors. Out of proposals sponsored by USA found 53 negotiated agreements, which had a small average positive announcement return. Authors concluded USA's actions were successful.
Wahal (1996)	1987-1993	All proposals	Public pension funds	356 proposals at 146 firms	Finds no significant target firm wealth effects from shareholder activism.
Carleton, Nelson, and Weisbach (1998)	1992-1996	Negotiated agreements	TIAA-CREF	62 targetings of 45 firms	Negotiated agreements are generally successful in achieving goals, but whether there are short-term wealth effects depends on issue.
Johnson, Porter, and Shackell (1997)	1992-1995	Executive compensation proposals	All sponsors	184 firms	Find no effect of proposals on executive compensation.
Johnson and Shackell (1997)	1992-1995	Executive compensation proposals	All sponsors	169 proposals at 106 firms	Find no effect of proposals on executive compensation.
Bizjak, and Marquette (1998)	1987-1993	Poison pill rescission proposals	All sponsors	191 proposals at 116 firms	Pill rescission proposals are submitted more frequently when firm performance has been poor, when the initial market reaction to the adoption of the pill is negative, and when insider and block ownership of stock is low. Firms that receive shareholder proposals regarding poison pills are more likely to restructure or rescind the pills.
Campbell, Gillan, and Niden (1998)	1997	All proposals	All sponsors	681 proposals at 394 firms	Governance-related proposals generally receive higher support than social-issue proposals. A high proportion of proposals sponsored by individual investors are omitted on technical grounds.
Crutchley, Hudson, Jensen (1998)	1992-1997	Target list firms	CalPERS	47 firms	Success of CalPERS activism depends on time period studied. Unless management is pressured into making substantial changes, investors will not benefit from activism.
Del Guercio and Hawkins (1999)	1987-1993	Governance proposals	5 public pension funds	266 proposals at 125 firms	Shareholder proposals are not associated with accounting or stock market performance, but are associated with subsequent changes in corporate governance and corporate activities such as asset sales or restructurings.
Huson (1998)	1990-1992	All governance activism	CalPERS	18 firms	Found significant changes in the real activities of targeted firms. In addition, market reaction to such transactions was significantly more positive, on average, than to comparable transactions before the targeting.
Gillan, Kensinger and Martin (2000)	1989-1992	Activism aimed at Sears Roebuck	All sponsors	1 firm	Suggestive of activism having a positive influence on Sears' value and that management was pressured to restructure faster than they would have done absent shareholder pressure.
Opler and Sokobin (1995)	1991-1994	Targeted firms on focus lists	Council of Institutional Investors (CII)	117 firms	In year after being listed, firms averaged an 11.6% increase in share price suggesting that coordinated shareholder activism creates shareholder wealth.
Schwab and Thomas (1998)	1996-1997	Governance proposals	Labor unions	126 proposals at 91 firms	Argues that unions need to align with shareholders and in so doing, they shift from an antagonistic player to a strategically cooperative player in corporate governance.
Thomas and Martin (1998)	1994	Governance proposals	All sponsors	309 proposals	Find that labor union proposals receive at least as much support as other shareholder group proposals.

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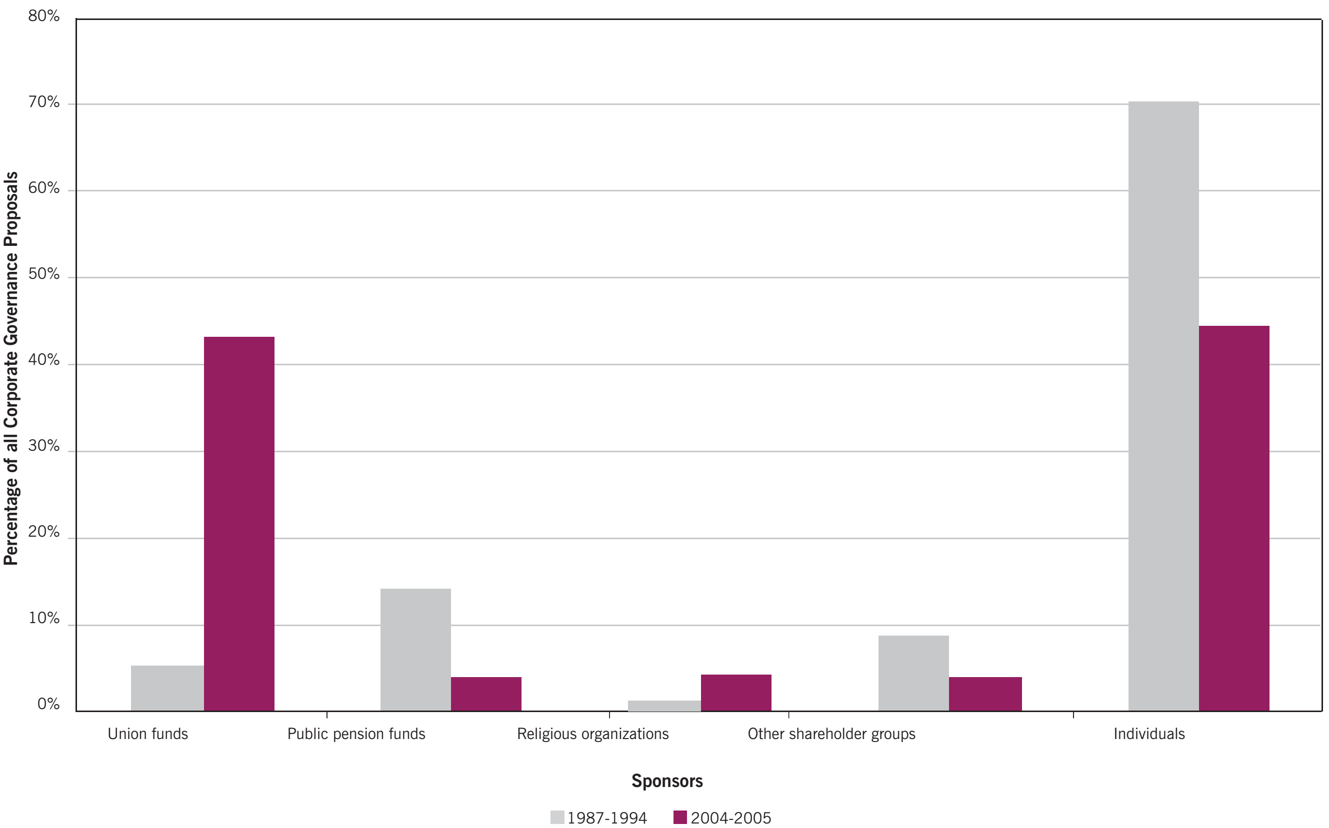
Table 2 **continues**

Study	Sample Period	Type of Activism	Sponsor of Activism	Number of Firms And Activism Events	Conclusions Regarding Outcomes
Gillan and Starks (2000)	1987-1994	Governance proposals	All sponsors	2042 proposals at 452 firms	Shareholder reaction and voting outcome on proposals depend on issue and identity of sponsor. Proposals sponsored by institutions receive much higher votes and more positive reactions.
Prevost and Rao (2000)	1988-1994	Governance proposals	Public pension funds	146 proposals	Find strong negative wealth effects on announcement of targeting.
Choi (2000)	1991-1995	Governance proposals	Institutions	362 proposals at 278 firms	Examines proposals before and after SEC changes in proxy reform rules and finds no difference in voting outcomes after the changes.
Caton, Goh and Donaldson (2001)	1991-1995	Targeted firms on focus lists	Council of Institutional Investors (CII)	108 firms	Negative market reaction to list release, but increased earnings estimates by financial analysts for a subsample companies with solid growth opportunities.
Hann (2002)	1989-1996	Targeted firms	5 public pension funds	150 targeted firms	Characteristics of target can explain whether activism results in successful changes. Can explain why so few studies find significant changes in target.
Song and Szewzcyk (2003)	1991-1996	Targeted firms on focus lists	Council of Institutional Investors (CII)	156 firms	Find little evidence of the efficacy of shareholder activism by institutional investors.
English, Smythe, McNeil (2004)	1992-1997	Target list firms	CalPERS	63 targetings of 47 firms	Announcement effects depend on index used. For some, significantly positive announcement effects, but no long term abnormal performance after six months.
Wu (2004)	1988-1995	Target list firms in Forbes 500	CalPERS	37 firms	Public targeting is associated with a decrease in the number of inside directors, an increase in the likelihood of CEO dismissal, and an increase in the sensitivity of CEO turnover to performance.
Thomas and Cotter (2006)	2002-2004	Governance proposals	All sponsors	1454 proposals	Examines shareholder proposals post-Enron and finds many similarities in voting outcomes and market reactions as compared to previous studies. Also reports that recent targeting is not restricted solely to poor performers, and that private investments groups and individuals are most effective in garnering voting support.
Barber (2006)	1992-2005	Target list firms	CalPERS	115 firms	Short-term market reaction to target announcements suggests positive returns.
Del Guercio, Wallis and Woidtke (2006)	1996-2003	Just vote no campaigns	All sponsors	92 firms	Activism is associated with higher forced CEO and director turnovers and that forced CEO turnovers have positive valuation effects. Activism affects market for directors.
Nelson (2006)	1990-2003	Target list firms	CalPERS	91 firms	Studies on CalPERS activism have used biased parameters, too long a window and do not exclude contaminating events. Once these are corrected, there are positive results pre-1994, but none post-1994.
Akyol and Carroll (2006)	1990-2004	Poison pill rescission	All sponsors (including company initiated removals)	126 firms	Companies remove pills due to shareholder pressure, including pressure by way of pill rescission proposals. Company initiated pill removals are also associated with potential pressure from shareholders.
Prevost, Rao and Williams (2006)	1998-2002	Governance proposals	Union funds	481 proposals at 232 firms	Results do not support the hypothesis that union fund proposals are indicative of conflicts of interest on the part of such funds seeking to extract gains for employees.
Zenner, Shivdasani, and Darius (2005)	2004-2005	All types of activism	Hedge funds	31 firms	Found significant returns on announcement of activism, primarily driven by returns to targets where the activism was related to merger and acquisition activity.
Bradley, Brav, Goldstein, and Jiang (2006)	1989-2003	Activism with regard to closed-end funds	All sponsors, most were hedge funds	Over 200 open-ending attempts	Activists target closed-end funds with high discounts but discounts shrink on activism.
Klein and Zur (2006)	2003-2005	All types of activism	Hedge funds	194 firms	Found significant returns for period surrounding 13D filing date; no improvement in accounting performance for year after filing but hedge fund goals were at least partially met about 60% of time.
Brav, Jiang, Partnoy and Thomas (2006)	2004-2005	All types of activism	Hedge funds	374 firms	Found significant returns for period surrounding 13D filing date; Hedge fund achieved their goals in a third of cases and partially achieved their goals in another third of cases.

Figure 3 **Sponsors of Corporate Governance Proposals**



One exception is a study of direct negotiations with targeted companies by one notably activist shareholder, TIAA-CREF.[38] The study found that, of the 45 companies contacted by TIAA-CREF, 71% reached a negotiated settlement prior to the vote on the proposal. The remaining 29% of the firms resisted TIAA-CREF's pressures and the proposals went to a vote. These results suggest both the challenge for researchers posed by unreported events and the understatement of the extent of shareholder activism by studies that focus only on proposals that get put to a vote.

A second problem with such studies is the difficulty in establishing a causal link between shareholder activism and subsequent changes in governance, and between such governance changes and changes in corporate performance. In other words, are observed changes in governance the result of shareholder proposals, public pressure, behind-the-scenes negotiations with activists, or some other influence? And did the changes actually result in increases in the efficiency and value of the targeted firms?

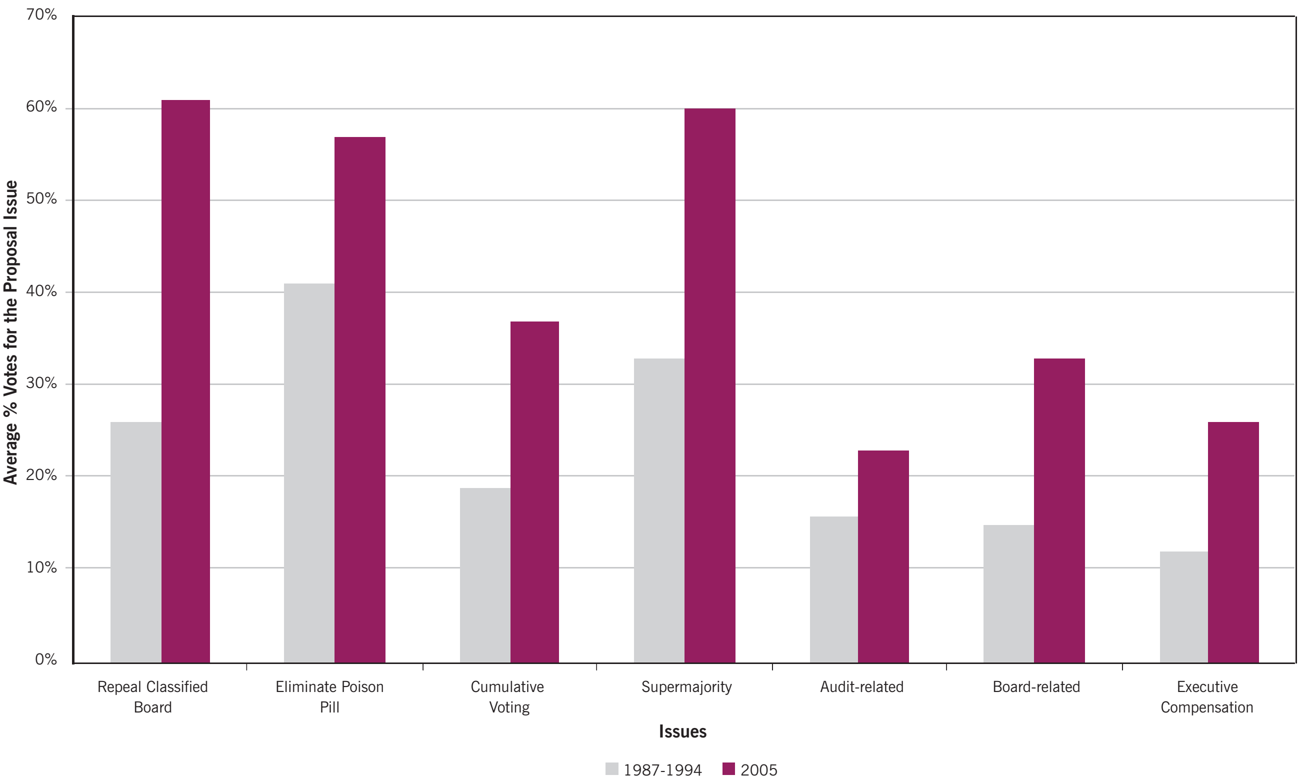
For example, one major aim of shareholder activists has been to get more independent directors on the board. Although we can observe whether there are more independent directors, it is often difficult to attribute the increase to a particular shareholder action. And it is even harder to assess whether the change in the composition of the board led to higher profits and share values.

With these caveats in mind, we now present and discuss the empirical evidence on the effects of shareholder activism. Table 2 provides a summary of existing studies of shareholder activism, including the sample period, the type of activism, the identity of the shareholder activists, and the number of proposals and firms. As can be seen in the table, the sample periods all begin after 1985, the beginning of institutional investor activism.[39] Although many of

38. Carleton, Nelson, and Weisbach (1998).

39. The shortest analyses focus on proposals in a single year (for example, Gordon and Pound, 1993; Campbell, Gillan and Niden, 1998). The longest is our own study of the eight year period 1987-1994 cited earlier (Gillan and Starks, 2000). Most of the studies examine the submission of shareholder proposals related to corporate governance, but some studies also include shareholder proposals aimed at social reforms (John and Klein, 1995; Campbell, Gillan and Niden, 1998). In addition, some studies emphasize other types of activism: Firms on focus lists (Anson, White and Ho, 2004; Barber, 2006; Caton, Goh and Donaldson, 2001; Crutchley, Hudson, Jensen, 1998; English, Smythe, McNeil, 2004; Nelson, 2006; Opler and Sokobin, 1995; Song and Szewczyk, 2003;), negotiated agreements (Carleton, Nelson and Weisbach, 1997; Strickland, Wiles and Zenner, 1996), and all activism aimed at a single firm (Gillan, Kensinger, and Martin 2000; Smith, D., 1996).

Figure 4 **Voting Outcomes for Proposals**



the studies include all active institutions ("sponsors"), some focus on subsets of sponsors such as public pension funds, labor unions, coordinated groups, or individual pension funds. Finally, the studies vary widely in the number of firms and activist "events" examined.

As might be expected with such a range of issues and sponsors, the studies produce some strikingly different assessments of the extent and effects of shareholder activism. In addition to analysis of the kinds of companies targeted by activists, researchers have devised and tested numerous measures of the influence of shareholder activism. Chief among them are short-term stock market reactions to announcement of shareholder initiatives, longer-term stock market and operating performance, outcomes of votes on shareholder proposals, and changes in corporate strategy and investment decisions in response to activism. In the following sections, we discuss the empirical evidence concerning each of these different ways of evaluating the effectiveness of shareholder activism.

Short-term Stock Market Reactions

One potential measure of the effects of shareholder activism is whether the announcement of such activism is accompanied by an increase in the company's value. That is, do other investors change their expectations about the value of the firm because they believe that activism will lead to real economic changes? To measure such an increase, researchers commonly examine changes in stock prices around the date of the announcement of the activism. But this kind of analysis has a number of limitations.

One problem is the difficulty in ascertaining exactly when investors first receive the information that a company has been targeted by a shareholder activist. For example, in examining shareholder proposals, the researcher needs to decide whether the critical date is the date of any initial letter to the firm, the proxy mailing, the shareholders' annual meeting, or a separate press release. Given the private nature of communications between corporate management and public pension funds, most studies consider the date of the proxy mailing to be the earliest release of news of a shareholder proposal. If this news caused investors to reassess the firm's valuation, we would expect to be able to detect the change around this date.

On the other hand, some shareholder activists, including CalPERS and the Council of Institutional Investors, announce the list of companies they are targeting at the beginning of the proxy season. When this happens, some of the information has already reached other investors. In addition, many companies are repeat targets, in which case their inclusion may not convey news about the firm in that particular year.

Some studies have also examined stock returns around the date of the shareholders' annual meeting, with the idea that investors may change their expectations based on the voting outcome of the shareholder proposals. The problem with this approach, however, is that other important information is often made public during annual meetings. And the same objection can be made to the use of the proxy mailing date, given the other information disclosed in corporate proxy statements.

The second problem with analysis of short-term market reactions is that it is not clear what the investors' responses should be on learning that a company has been targeted by an active shareholder. Shareholder proposals are advisory in nature, which means that even if the proposals pass with 100% of the vote, management is not required to implement their directives. In addition, there is a question as to whether the announcement is good news (because it means there is increased monitoring) or bad (because it implies institutional investors could not come to a negotiated agreement with management).

In general, for the overall samples of shareholder proposals, the studies have found no significant abnormal returns around the assumed date of information release.[40] This result tends to be true regardless of whether the study used the announcement date of the target list, the mailing dates of proxies, the annual meeting date, or the *Wall Street Journal* announcement date.

Nevertheless, some studies have reported significant responses to subsamples of the proposals or announcements. For example, some studies found a negative abnormal return for proposals to rescind poison pills, while others reported negative abnormal returns for board-related and antitakeover proposals (which could be driven by the poison pill rescission proposals in this category).[41] The study of proposals by TIAA-CREF discussed earlier found that for specific issues like board diversity and blank check preferred there were significant market responses—negative in cases involving board diversity and positive for blank check preferred—around the dates of targeting letters from TIAA-CREF.[42] A more recent study by Andrew Prevost and Ramesh Rao focused on two subsamples—companies targeted by CalPERS' proposals and firms receiving proposals from public pension funds—and reported significantly negative stock returns in the three days surrounding the mailing date of the proxy statement containing the proposal.[43] One interpretation is that the failure of management to negotiate with activist shareholders is viewed as bad news in the marketplace. Another is that the event date is noisy, and the abnormal return being captured reflects information other than that related to the shareholder proposal or targeting event.

Some studies have examined the reaction to other aspects of shareholder activism. For example, Deon Strickland, Ken Wiles, and Marc Zenner found that the announcement of a negotiated settlement with a target firm is associated with significantly positive returns, on average.[44] One interpretation of this finding is that such settlements bring about a reduction of uncertainty about some potential liability while also conveying management's commitment to avoid the offending behavior in the future. Another recent study examines a particular activist practice in which institutional investors target the board rather than corporate governance practices by conducting "Just Vote No" campaigns during director elections.[45] The authors report that such campaigns are associated with higher forced CEO and director turnover and that the reputations of the targeted directors are affected by the campaigns.

Voting Outcomes on Shareholder Proposals

Another test of the efficacy of shareholder activism is to examine the voting outcomes of shareholder proposals. In so doing, several factors must be considered. First, shareholder proposals, as already noted, are only advisory; management is not required to adopt the proposal if it receives majority support. Moreover, shareholder activism conducted through the proxy process is subject to considerable managerial control in that managers have the ability to influence both the voting turnout and results. They can do so by excluding shareholder proposals from the proxy (subject to SEC oversight) and by hiring proxy solicitors to garner support for their position.[46]

Studies of voting outcomes on shareholder proposals for earlier periods (late 1980s to early 1990s) have reported that voting support for proposals has depended on a number of variables: the issue addressed by the proposal; the identity of the sponsor; insider ownership; institutional ownership; the number of times a proposal had been submitted; the governance structure and performance of the target firm; and whether the proposal was related to the removal of antitakeover mechanisms. Specifically, favorable votes have been higher in cases involving poison pill repeal proposals, proposals sponsored by public funds, companies with fewer insiders,

40. See, for example, Carleton, Nelson, and Weisbach (1998), Del Guercio and Hawkins (1999), Gillan and Starks (2000), Karpoff, Malatesta and Walkling (1996), Prevost and Rao (2000), Smith (1996), Song and Szewczyk (2003), and Wahal (1996).

41. Bizjak and Marquette (1998) and Gillan and Starks (2000) find negative abnormal returns for pill recission proposals Del Guercio and Hawkins (1999) focus on board-related issues and the repeal of antitakeover measures (including pills).

42. See Carleton, Nelson, and Weisbach (1998).

43. Generalizing from some of these results should be viewed with caution, for the number of observations in the subsamples are small (22 and 16 in the Carleton, Nelson and Weisbach paper (1998) and 15 and 23 in the Prevost and Rao study (2000).

44. Strickland, Wiles, and Zenner (1996).

45. Del Guercio, Wallis, Woidtke (2006).

46. When seeking support for management proposals, management can bundle hard-to-pass decisions with other proposals and classify proposals as routine in order to increase the number of votes in their favor; Bethel and Gillan (2002).

smaller companies, and companies that had performed poorly in the stock market. Proposals sponsored by institutions, labor unions, or coordinated shareholder groups have also received substantially more support than proposals sponsored by individual investors.[47] Our own study (mentioned earlier) also found a general increase in votes supporting governance proposals over the period we studied (1987-1994).

In addition, research shows that governance proposals typically receive greater support than do social responsibility proposals. For example, a study of the 1997 proxy season reported that governance proposals received an average 24% of votes cast during that year, while social proposals received an average of just 6.6%. Furthermore, less than one-third of all social proposals were voted on in contrast to almost 50% of governance proposals.[48]

According to the IRRC, 8,600 shareholder proposals were put on proxies during the period 1973-2004. Less than 10% of these won majority support, but, strikingly, more than half of the majority votes occurred in the 2000-2004 period. Figure 4 shows differences in voting outcomes for types of shareholder proposals submitted in 2005 as compared to the earlier 1987-1994 period. As the figure shows, votes in support of proposals have increased significantly, as have the number of proposals aiming to repeal classified boards, eliminate poison pills, and remove supermajority amendments that have commanded over 50% of the shareholder vote. Votes in favor of shareholder proposals on executive compensation have more than doubled, from 12% to 26%. The general increase in voting support for many shareholder proposals likely reflects a number of factors: more concerted action by institutional investors, the existence of proxy voting advisory firms, and the public disclosure of mutual fund proxy votes.[49] One example of more concerted action are the "Just Vote No" campaigns targeting boards of directors.[50]

Several studies have also examined the potential conflicts of interest faced by investment managers when voting on management and shareholder proposals. An early study by James Brickley, Ron Lease, and Cliff Smith suggested that institutional investors that have business dealings with portfolio companies may be pressured to vote with management.[51] However, the more recent evidence on this issue does not suggest that institutions, on average, are "captured" by their business ties.[52]

Studying potential conflicts of interest on the part of mutual funds has resurfaced with new SEC regulations requiring that funds disclose the way they vote their shares in portfolio firms. Two recent studies examining the voting practices of large mutual fund families suggest that the funds studied are no more likely to vote with management at client than non-client firms. But if there is little direct evidence of conflicts of interest,[53] investment style does seem to influence voting decisions, with stock pickers tending to vote with management and passive indexers more likely to vote against management. Such studies have also reported that funds with longer investment horizons tend to vote in favor of shareholder proposals that are likely to increase shareholders' wealth and rights, and in cases involving companies with weaker governance or entrenched management.[54] Finally, other work suggests that, while shareholder support for management proposals has declined over time, there is no evidence to suggest that the requirement that funds disclose their votes has led to a change in mutual fund voting.[55]

Voting on Management Proposals

Here the studies suggest that management proposals generally pass (they are generally put to shareholder vote only when management is confident of a victory) and uncontested directors receive most of the votes. The evidence also suggests that the degree of shareholder support varies with corporate performance, ownership structure, and a number of characteristics of the proposal. For example, several studies conclude that the percentage of votes cast in favor of stock option plan proposals decreases with the perceived cost to shareholders, typically measured as the potential dilution from the plan.[56] Finally, while there is relatively little variation in voting for directors, recent evidence suggests that voting support for directors has been related to firm performance, director performance, and a firm's shareholder rights. More specifically, directors receive fewer votes when they attend less than 75% of board meetings, and when Institutional Shareholder Services recommends that their clients vote against them.[57]

Long-term Performance

The two previous measures of the effects of shareholder activism—stock market reactions to announcements of initiatives and voting outcomes on proposals—are both short-term in nature. But the effects of such activism are likely to show up only gradually over time. To investigate

47. See Bizjak and Marquette (1998), Gillan and Starks (2000), Gordon and Pound (1993), Thomas and Martin (1998).

48. See Campbell, Gillan and Niden (1998).

49. According to Alexander, Chen, Seppi, and Spatt (2006) proxy advisory services have significant effects on voting outcomes and their recommendation announcements are associated with significant abnormal returns.

50. Del Guercio, Wallis, and Woidtke (2006).

51. Brickley, Lease, and Smith (1988).

52. To consider one example, Karen Van Nuys (1993), when examining the 1987 proxy fight at Honeywell, found that banks and insurance companies were more supportive of management-sponsored antitakeover proposals than public pension funds and independent investment managers. But, on closer inspection, Van Nuys found no evidence of business ties between Honeywell and its shareholders that would account for this pattern of voting.

53. Davis and Kim (2006) and Rothberg and Lilien (2005).

54. Ashraf and Nayaran (2006) and Rothberg and Lilien (2005).

55. Cremers and Romano (2006).

56. See Bethel and Gillan (2000), Martin and Thomas (2005). Morgan and Poulsen (2001), Morgan, Poulsen and Wolf (2006), In the context of mergers, Burch, Morgan and Wolf (2004) report that voting support varies substantially with firm and deal characteristics.

57. Cai, Garner, and Walkling (2006) and Fischer, Gramlich, and Miller (2006).

this possibility, studies have examined the long-term performance of the targeted companies, both their returns to shareholders and their operating performance.

The studies' definitions of what constitutes "long-term" have varied from one year to five years. The problem noted earlier of uncertainty about the linkage between cause and effect is exacerbated by long-term performance measures. Even in cases of activism that lead to significant improvements in operating performance or stock appreciation over the next several years, it is difficult to ascertain whether it was activism *per se* that caused the changes.

The general results of studies of the long-term stock performance of targeted companies have been mixed. An early study (by one of the present writers) focusing on companies targeted for the first time in 1990 or 1991 found no evidence of significant wealth effects.[58] Similarly, two other studies reported no evidence of significant wealth changes for companies targeted over the 1987-1993 period.[59] But studies of interventions by a single institutional investor come to a different conclusion. For example, Stephen Nesbitt's study of CalPERS' governance initiatives showed significant gains for shareholders.[60] And Michael Smith found that those of CalPERS' targets that cooperated with the fund's suggestions saw significant increases in shareholder wealth, while the shareholders of companies that resisted CalPERS' pressure experienced reductions in wealth.[61]

Virtually all studies of long-term operating performance have reported no statistically significant changes in the operating performance of targeted companies.[62] Another potential problem with studies of long-term performance is the choice of an appropriate control group when measuring "abnormal" performance. Since the control firms are usually selected on the basis of being in the same industry and having similar performance, two related questions arise: First, did other activists not included in the study target the control firms? Second, if the control firms were not targeted, yet operate in the same industry and had the same performance, then why were the control firms not targeted as well (i.e., there must be important differences between them)?

With regard to the first question, there may be a time-period effect. That is, the activism may be attributed to one activist, or set of activists, when in fact the activism process had been initiated earlier by other investors. For example, a case study of Sears Roebuck (involving one of the present writers) showed that while Sears appeared on CalPERS' target list, the firm was also subject to a proxy fight for board representation by shareholder activist Bob Monks. Moreover, the activism at Sears, although leading to changes in the company's real activities and governance structure, took over three years to reach a "satisfactory" conclusion.

With regard to the second question, researchers need to be careful when assessing why the control firms were somehow insulated from targeting. Given the previous studies of the characteristics of targeted firms, one has to consider a number of possibilities: were the control firms already in the process of change? Or were there other factors at work, such as lower institutional ownership or greater insider ownership? A related issue is whether any such differences in firm characteristics had an effect on the long-term performance, regardless of the targeting.

Changes in Other Aspects of the Target Firm

A number of studies have investigated how other aspects of the targeted companies have changed in response to shareholder activism. The primary focus of these studies has been on changes in governance structure, investment decisions, and management.

On changes in governance structure, Michael Smith reported that 72% of the companies targeted by CalPERS between 1988 and 1993 either adopted CalPERS' proposed changes or made changes resulting in a settlement with the investor. Similarly, poison pills were more likely to be restructured, removed, or put to a shareholder vote after being the subject of a shareholder proposal. Moreover, shareholder pressure has been particularly effective in pill-removal post-Enron.[63] One study of pension fund activism showed that, during the three-year period after targeting, the targeted companies saw a greater frequency of governance events, including shareholder lawsuits, non-pension-fund-sponsored shareholder proposals, or public 'no' votes for directors.[64] On the other hand, another study conducted around the same time found no evidence that the submission of a shareholder proposal on executive compensation was followed by significant changes in compensation levels or pay-for-performance sensitivities.[65]

In an extensive study of the effect of CalPERS' activism on the real activities of targeted companies, Mark Huson found significant changes in the real activities of these firms. In particular, the targeted firms had significantly more divestitures, fewer acquisitions, and more joint ventures. The study also reported that the market reaction to such transactions was significantly more positive, on average, than to comparable transactions before the targeting.[66] Similarly, in their study of companies targeted by five

58. Gillan (1995).
59. Del Guercio and Hawkins (1999) and Wahal (1996).
60. Nesbitt (1994).
61. Smith (1996). Another study, Opler and Sokobin (1995), reported that stock market performance improved after a company appeared on the Council of Institutional Investors' focus list. But more recent papers call this result into question. See, particularly Song and Szewczyk (2003).
62. Del Guercio and Hawkins (1999), Karpoff, Malatesta and Walkling (1996), Smith (1996), Strickland, Wiles and Zenner (1996), and Wahal (1996).
63. Akyol and Carroll (2006) and Bizjak and Marquette (1998).
64. Del Guercio and Hawkins (1999).
65. Johnson, and Shackell (1997) and Johnson, Porter and Shackell (1997).
66. Huson (1997).

major public pension funds, Diane Del Guercio and Jennifer Hawkins found a greater incidence of restructurings, including asset divestitures and employee layoffs than for a comparable control group of companies.[67]

In contrast, the results of studies focusing on management turnover have been mixed. Some studies reported finding no relation between CEO turnover and shareholder proposals, although there is evidence of higher turnover for other senior managers. [68] But other studies reported higher CEO turnover, as well as a decrease in board size, in companies targeted by CalPERS.[69]

One other way to test the effectiveness of investor activism is to examine the extent to which boards have implemented majority vote shareholder proposals, and how that has changed, if at all, over time. A recent study concluded that the frequency of implementations has more than doubled, from 16% in 1997 to over 40% in 2003-2004. Moreover, the probability that a proposal was implemented has increased with the percentage of votes cast in favor of the proposal and the percentage of stock owned by activist shareholders. At the same time, however, shareholder proposals related to board issues and executive pay have been less likely to be implemented than other kinds of proposals.[70]

New Kids on the Block: Hedge Funds and Shareholder Activism

During the past decade or so, hedge funds have not only entered the shareholder activism arena, but have become a dominant force. Recent examples include Relational Investors and Home Depot, Pershing Square and Wendy's International, Icahn Partners and Time Warner, and Breeden Partners and Applebee's International.

The hedge funds have a variety of goals in their activism. The most common ones are as follows: changing management strategy or board decisions; seeking a board seat for either input, control, or information purposes; effecting corporate governance changes; forcing a buyout or sale of a division; and increasing cash distributions to shareholders through dividends or share repurchases. While the hedge funds use some of the same strategies as those employed by the traditional institutional activists—including shareholder proposals, direct negotiations, and use of the media—they also use other means such as proxy contests, litigation, or outright takeover.[71] Even their use of traditional institutional activist strategies is often different in its application. For example, one study concludes that the Hermitage Fund has been successful in lobbying the media to cover corporate governance violations of Russian public corporations, and thereby helping to bring about the Fund's desired changes in those companies.[72]

One form of shareholder activism that is sometimes practiced by hedge funds is relationship investing. By definition, this is an ongoing relationship between the institutional investors and the firm.[73] And for a number of reasons, the shareholder consequences of such activism are difficult to measure. As noted earlier (when discussing the case of Sears), when activism occurs over a number of years and often involves different investors, it is difficult to attribute the outcome to any single activist or strategy.

Although proxy contests were a traditional form of shareholder voice that was used extensively in the 1980s, the rising expense of waging a proxy battle caused use of this tactic to fall off sharply. But with the rise of hedge funds, the proxy contest has staged a comeback. For example, there were 91 proxy contests over board elections in 2006, up from 40 in 2005 and 30 in 2004; most of the increase has been attributed to the growth and proliferation of hedge funds engaged in such contests.[74] Another likely contributor to the recent jump in proxy contests was the SEC's 1992 easing of rules limiting communication between shareholders.[75]

A number of questions have arisen about the effectiveness of hedge fund activism: For example, have hedge funds really succeeded in adding value to the companies they have targeted; or have most of the returns to hedge funds been short-terms profits at the expense of other, longer-term shareholders? Do hedge funds have the appropriate organizational structure to bring about change in the underlying target firms? And do hedge funds' incentives for activism differ from those of other kinds of institutional activists.[76]

While there is no shortage of anecdotal reports of the failures (such as Icahn Partners's efforts with Blockbuster) and successes (Relational Investors's recent ouster of the CEO of Home Depot) of hedge fund activism, the general lack of information about hedge funds' activities and holdings has prevented researchers from assessing benefits and costs. Nevertheless, a handful of studies have attempted systematic investigations of the consequences of hedge fund activism using the information provided in the funds' filings

67. Del Guercio and Hawkins (1999).

68. Smith (1996) and Karpoff, Malatesta and Walkling (1996) Del Guercio and Hawkins (1999) find that the target firms do not have a higher frequency of CEO turnover, however, Del Guercio and Hawkins (1999) do find a higher frequency of turnover for other executives.

69. Huson (1997) and Wu (2004), report increased turnover, Wu, in particular, reports that board size declines.

70. Ertimur, Ferri, and Stubben (2006).

71. Kahan and Rock (2006), Pearson and Altman (2006), and Zenner, Shivdasani, and Darius, (2005).

72. Dyck, Volchkova, and Zingales (2006).

73. Any long-term relationship between large shareholders and companies can be termed relationship investing. For studies on block shareholders, see for example, Bethel, Liebiskind, and Opler (1998), Denis and Kruse (2000), and Denis and Serrano (1996). For studies on relationship investing specifically, see Bethel and Gillan (2007), Bhagat, Black and Blair (2004), Gillan, Kensinger, and Martin (2000), Martin and Kensinger (1996), Rock (1994),and Wruck and Wu (2005).

74. Whitehouse, K., 2007, Proxy Fights Hit High in 2006, and More Seen for 2007, Dow Jones News Service.

75. See, for example, Collins and DeAngelo (1990), DeAngelo (1988), DeAngelo and DeAngelo (1989), Faleye (2004), Ikenberry, and Lakonishok (1993), Mulherin and Poulsen (1998) and Pound (1988).

76. Kahan and Rock (2006).

of 13Ds. For example, in a recent study of 194 13D filings by 102 hedge funds during the period 2003-2005 period, the authors reported a 61-day announcement period return of 10.3%.[77] Another study (by different authors) of 374 13D filings by 110 hedge funds during 2004-2005 reported a 20-day announcement period return of 5-7%.[78]

These results indicate that there are short-term gains associated with hedge fund activism. But, one problem with drawing firm conclusions from these results is our inability to ascertain when the hedge funds purchased and sold the shares, making it difficult to determine whether the hedge funds themselves earned abnormal returns on their investments. One study that may help resolve this issue examined the actual trades of a U.K. fund (the Hermes U.K. Focus Fund) and reported that the fund earned returns in excess of the benchmarks.[79] In the U.S., a study of Relational Investors' activities (by one of the present writers) provides evidence that the fund has succeed in targeting underperformers and beating benchmark returns.[80]

It is also difficult to distinguish announcement effects that derive from the knowledge that a hedge fund is engaging in shareholder activism from the longer-term effects that actually result from the activism. The study of the Hermes fund cited above accomplished this by linking the (longer-term) excess returns derived from the fund's activism directly to the success of specific initiatives, such as replacing directors, blocking diversifying acquisitions, and increasing payouts. And consistent with these findings, two studies of U.S. hedge fund activism have reported that management often acquiesces to the hedge funds' demands (at least partially in over 60% of the cases examined).[81]

A study of the role of activism in "opening-ending" closed-end funds provides further evidence of the success of shareholder activists, primarily hedge funds. Activists pressing for the open-ending of closed-end funds have used a variety of tactics, including negotiations, shareholder proposals, and proxy contests, with the latter accounting for a little over half of the attempts. No strategy has been completely reliable, as the authors report that the number of successful open-endings is much smaller than the number attempted. But even unsuccessful attempts at open-ending closed-end funds have tended to narrow the discounts at which the funds trade in relation to their NAVs.[82]

On the other hand, legal scholars have expressed concern about potential problems related to some aspects of hedge fund activism. For example, Henry Hu and Bernie Black have noted potential problems associated with the separation of economic ownership from voting rights—a separation that, according to Hu and Black, has been exploited by hedge funds in their relatively new practice of voting shares they no longer own. (Such a practice, known as "empty voting," could conceivably be used by short sellers to advocate measures that would reduce firm value.) Hedge funds can also achieve and maintain effective economic ownership without having to reveal it by forgoing voting rights (a condition that authors term "hidden ownership"). And if, as some have argued,[83] hedge funds have a shorter-term orientation than other investors, such ownership could cause problems.

Conclusion

Investor activism in the form of shareholder proposals has existed since the SEC's adoption in 1943 of Rule 14a-8. Between 1943 and the mid-1980s, the shareholder proposal process was almost exclusively the domain of individual shareholders and religious or political groups. But with the initiation of public pension fund activism in 1985, the involvement of large institutional shareholders increased dramatically.

The main motive for active participation by institutional investors in the monitoring of corporations has been the potential to enhance the value of their investments. But since the active investors incur *all* the costs associated with such activism (while the benefits accrue to all shareholders), only shareholders with large positions are likely to obtain a large enough return on their investment to justify the costs.

The evidence provided by empirical studies of the effects of shareholder activism is mixed. While some studies have found positive short-term market reactions to announcements of certain kinds of activism, there is little evidence of improvement in the long-term operating or stock-market performance of the targeted companies. Studies have reported significant changes in the business activities of companies targeted by shareholder initiatives, but it is difficult to establish a causal relationship between shareholder activism and these changes. The relatively recent entrance of hedge funds into shareholder activism has provided more evidence of gains from activism, but the long-term effects are still unknown and warrant more research.

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77. Klein and Zur (2006).
78. Brav, Jiang, Portnoy and Thomas (2006).
79. Becht, Franks, Mayer and Rossi (2006) .
80. Bethel and Gillan (2007).
81. Brav, Jiang, Portnoy and Thomas (2006) and Klein and Zur (2006).
82. Bradley, Brav, Goldstein and Jiang (2006).
83. Kahan and Rock (2006).

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