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Corporate governance proposals and shareholder activism: the role of institutional investors☆

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Abstract

We study shareholder proposals across a period of substantial activity and find systematic differences both across sponsor identity and across time. To measure the success of shareholder activism, we examine voting outcomes and short-term market reactions conditioned on proposal type and sponsor identity. The voting analysis documents that sponsor identity, issue type, prior performance and time period are important influences on the voting outcome. Proposals sponsored by institutions or

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coordinated groups appear to act as substitutes gaining substantially more support than proposals sponsored by individuals. The nature of the stock market reaction, while typically small, varies according to the issue and the sponsor identity.

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1. Introduction

During the last 15 years 'shareholder activism', also known as 'relationship investing', has evolved to become an important characteristic of financial markets. The primary emphasis of activist shareholders has been to focus on the poorly performing firms in their portfolio and to pressure the management of such firms for improved performance, thus enhancing shareholder value.

A key feature of this activism derives from the Securities and Exchange Commission (SEC). The SEC's Shareholder Proposal Rule 14a-8 allows shareholders to submit issues for inclusion in the proxy material and for subsequent presentation at the annual general meeting. If such issues are properly presented at the annual general meeting, they will be voted on. The use of shareholder proposal resolutions is often an expedient way in which activist shareholders can pursue their agendas. That is, the proxy process has provided these shareholders with a formal mechanism through which concerns about corporate governance and corporate performance can be raised.

While shareholder activism by institutional investors has gained increased prominence over the last few years, there has been limited empirical work investigating the effects of this activism.[1] The empirical work that has studied the issue has tended to concentrate on the activities of a particular institutional investor – Smith (1996), Huson (1997) and Nesbitt (1994) focus on the California Public Employees Retirement System (CalPERS); Carleton et al. (1998) focus on TIAA-CREF; Strickland et al. (1996) study a coalition of small investors – the United Shareholders' Association (USA); or specific proposals, e.g., poison pills (Bizjak and Marquette, 1998) and executive compensation (Johnson and Shackell, 1997). More recently, researchers have focused on the activities of

[1] Many legal scholars have discussed the implications of shareholder activism, e.g., Black (1992), Coffee (1993) and Romano (1993). Recent theoretical developments include Chidambaran and John (1998), Maug (1998) and Kahn and Winton (1998). For a more detailed overview of this literature, see Black (1998), Gillan and Starks (1998), or Karpoff (1998).