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The motivation and impact of pension fund activism[☆]

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Abstract

Pension funds have pursued an active role in corporate governance, although some question their effectiveness and motivations. We examine the impact and motivation of pension fund activism by studying the shareholder proposals of the largest, most active funds from 1987 through 1993. We find significant heterogeneity across funds in activism objectives, tactics, and impact on target firms, consistent with differing investment strategies. We find the funds are more successful at monitoring and promoting change in target firms than previously recognized. We also find no evidence to support motivations other than fund value maximization. © 1999 Elsevier Science S.A. All rights reserved.

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1. Introduction

Large public pension funds pursue a highly active role in the governance of companies principally through the submission of shareholder proposals. These proposals request changes ranging from altering the structure of board governance or management incentives to the removal of takeover defenses. Several studies conclude that shareholder proposals are generally ineffective. Some argue that this is not surprising given the agency problems within the funds themselves. Romano (1993) argues that public pension funds are subject to pressures to take actions that are politically popular, but that harm the funds' investment performance. Murphy and Van Nuys (1994) maintain that public pension funds are run by individuals who do not have the proper incentives to maximize fund value. Both studies argue that public fund managers may use proposals to generate publicity or enhance their reputations in order to gain future employment or political opportunities. In support of these arguments, Wahal (1996) and Karpoff et al. (1996) find little evidence that operating performance or share price improves for companies that are the targets of a shareholder proposal. In their survey articles, Karpoff (1998) and Black (1997) summarize the empirical evidence and conclude that proposals are ineffective.

We revisit the question of the motivation and impact of pension fund activism by studying the shareholder proposals of the largest and most active funds from 1987 through 1993. Although these funds appear to be quite similar, we show that recognizing important sources of heterogeneity aids in our understanding of the funds' underlying motivation and their impact on target firms. In particular, it is important to take into account any constraints dictated by their investment strategies. For example, a fund that is heavily indexed might pursue activism tactics aimed at boosting the performance of the stock market overall. A reasonable goal for an index fund might be to affect the behavior and management not only of the companies it targets, but also of many other companies that proactively make changes to avoid conflict and public scrutiny. Thus, a broad-based and highly publicized activism program might be interpreted as optimal from a fund value maximization perspective, rather than a source of perquisites to the fund managers. Richard Koppes, former chief counsel of the heavily indexed CalPERS fund, notes, 'It makes sense for us to try to raise the ocean in order to lift our boat' (remarks at Stanford University "Directors' College", March 21, 1996). Similarly, whether investment and trading decisions are made by internal fund managers, or delegated to outside managers, affects a fund's ability to profitably coordinate trading and activism decisions.

Our study contributes to ongoing research on the motivation and impact of shareholder activism in three ways. First, we document significant heterogeneity in fund objectives and activism tactics that are closely linked to differences in the funds' investment strategies. Second, we present evidence that shareholder

proposals have a significant impact on company policies, and that variation in impact across target firms is related to fund heterogeneity. Finally, we examine the target selection criteria of the funds, along with their trading patterns around the submission of proposals, and find no evidence that they are pursuing objectives other than beneficiary wealth maximization. We find that the funds differ in their tendency to buy and sell target shares around proposals, but these differences are consistent with their investment strategies. For example, the more heavily indexed funds show little variation in holdings around shareholder proposals, while the most actively managed fund exhibits significant and profitable movements in its holdings.

We focus on assessing the effectiveness of the funds in generating significant changes in target company policies. Overall, relative to a performance-, size- and industry-matched control sample, we find that companies receiving public pension fund proposals subsequently experience a higher frequency of governance events such as shareholder lawsuits as well as responsive corporate policies such as asset sales, restructurings, and layoffs. However, we find differences in target managements' response across the sample funds. Proposals sponsored by CalPERS, which has the largest ownership stakes among the externally managed indexed funds, appear to have the broadest and most substantial impact on subsequent events at target firms. Proposals sponsored by the other externally managed indexed funds, California State Teachers Retirement System (CalSTRS) and the New York City funds (NYC), also appear to generate significant change. In contrast, consistent with their narrower stated objectives, proposals sponsored by the internally managed College Retirement Equities Fund (CREF) and State of Wisconsin Investment Board fund (SWIB) are not associated with general increases in governance-related events. Rather, these two funds are generally successful in convincing corporate management to adopt the specific changes requested in the proposal.

We also find that firms that receive antitakeover proposals, those targeted by CalPERS, and those with proposals that garner enough votes to pass have a significantly higher probability of a takeover attempt, after controlling for variables related to takeover probability. This evidence suggests that proposals are low-cost mechanisms that can be fruitfully used to further a number of goals, such as putting pressure on management, signaling to the market the views of the fund regarding target company management, and building shareholder support for more costly governance activity such as takeovers. Similar to other studies, we find no evidence that this activity has significant effects on stock returns or accounting measures of performance in the three years following an initial targeting, and only sketchy evidence of positive effects in the short term. Overall, we conclude that the activist funds in our sample are generally successful in furthering their stated objectives. Furthermore, any potential agency problems within the funds do not appear to be responsible for the lack of measurable wealth effects.

We begin our study by providing some perspective on pension fund activism in general and our sample funds in particular. In Section 3, we describe the heterogeneity in investment strategies as well as activism objectives and tactics based on our interviews with key decision makers at the funds. Section 4 presents our main evidence on the corporate events that follow pension fund proposal submissions. Section 5 discusses important issues relevant to interpreting event study results in this context and presents evidence on accounting and long-run stock return measures of target performance. Section 6 examines whether the funds' target selection and trading behavior appear to be consistent with fund value maximization, and Section 7 presents our conclusions.

2. Historical perspective on shareholder activism: emergence of pension funds as activists

Shareholder proposals are a governance mechanism created by the Securities and Exchange Commission (SEC) under Section 14 of the Securities and Exchange Act of 1934. First used in 1942, proposals are brief statements submitted by a shareholder requesting a specific action by management. They are included in the annual proxy statement at the expense of the firm, along with managements official response and voting recommendations regarding the proposal. Proposals are almost always advisory due to provisions in state law. Even if the proposal passes with a majority of votes, management is not required to take the requested action. As intended by the SEC, however, a passing vote would effectively communicate the consensus views of dispersed shareholders to management. For a more complete description of rules regarding shareholder proposals see Gordon and Pound (1993) and John and Klein (1995).

Until the emergence of large institutional investors in the late 1980s, shareholder proposals were used almost exclusively by individual gadfly investors and social activist groups. During this time proposals never received enough votes to pass, and it was rare for a proposal to garner more than 10% of the votes in its favor. In 1987, institutional investors began to submit proposals on corporate governance topics. Around this time, corporate governance shareholder proposals began to gain significant support, despite management opposition. In our sample of 266 proposals sponsored by pension funds, the average percent of votes in favor is 34%, with 15 proposals receiving a majority.

The 1990s brought a few key developments. Partly in response to requests from activist funds, in 1992 the SEC relaxed restrictions in the proxy rules on disclosure of communications among shareholders, significantly lowering the costs and potential legal liability associated with shareholder activism. Sharara and Hoke-Witherspoon (1993) report that these were the first major changes to the proxy rules in nearly 40 years. They argue that the changes were in 'response

to institutional investors such as CALPERS' (pp. 327 and 337). Less public forms of activism such as private letters and phone calls to management became increasingly common. The funds reached the point at which few corporate managements ignored requests to meet with them, and many times management made the requested change without a proposal being formally filed. Thus, in many instances filing a proposal on the proxy statement became unnecessary and was used only as a 'last resort'. Of course, this would not work if the credible threat of the proposal did not exist. As Kurt Schacht of SWIB puts it, 'every once in a while the junkyard dog has to bite'.

We study the proposals submitted in 1987 through 1993 by the largest and most activist pension funds: CREF, CalPERS, CalSTRS, SWIB, and NYC. These funds represent 16% of the assets of the top 200 pension funds and 12% of the 1000 largest pension funds, according to data from the January 1995 issue of *Pensions and Investments*. Our five sample funds are also the most active funds on governance issues, representing 18% of all corporate governance proposals made in our sample period, according to data from the Investor Responsibility Research Center (IRRC).

Table 1 summarizes the distribution by topic and year of the 266 proposals submitted to 125 firms by our sample funds. Proposal topics fall into three main categories: voting issues, such as a request that voting be confidential; antitakeover issues, such as rescinding the poison pill or opting out of state antitakeover legislation; and board of directors issues, such as requesting that a majority of the board consist of independent directors. Voting issues are a popular proposal topic throughout the sample period, with antitakeover proposals becoming less common and board issues becoming more common in the 1990s. This trend in proposal topics mirrors the trend among non-pension fund proposal sponsors. Despite some overlap, however, some issues popular with individual gadflies were notably absent from the pension fund agenda. For example, according to the *IRRC Bulletin*, capping the level of CEO compensation was the second most popular proposal topic in 1994, but these were not sponsored by any of our sample funds.

The ownership statistics in Table 2 show that a significant portion of the sample funds' total portfolio value is devoted to activism, with relatively large stakes in individual targets. The dollar amount invested in portfolio firms targeted to receive proposals ranges from \$422 million at CalSTRS to \$2.2 billion at CREF. Although CalPERS is perceived to be the most activist fund, CREF has nearly double the dollar investment, and almost the same number of target firms, as CalPERS. The average percentage stake in target firms owned by the funds ranges from 0.4% for CalSTRS to 2.3% for SWIB. In contrast, Wahal (1996) reports that the average percentage stake in target firms by inactive institutional investors is only 0.3%. Public pension funds not only have large stakes in individual targets, they also tend to retain sole voting authority over their externally managed shares. According to Brancato (1993), public funds

Table 1
Frequency distribution of shareholder proposals by pension fund sponsor and by year

This table contains all shareholder proposals submitted to portfolio firms by the sample pension funds from 1987–1993, including those that were subsequently withdrawn by the pension fund. In the rare case of a proposal that is co-sponsored by two sample pension funds, it is counted only once under the primary sponsor

Proposal type	Fund sponsor						Year						Total	
	SWIB	CREF	CALPERS	CALSTRS	NYC		87	88	89	90	91	92		93
<i>Voting issues</i>														
Confidential voting	2	16	10	5	85		0	11	28	28	22	15	14	118
One share one vote	0	0	0	1	0		1	0	0	0	0	0	0	1
Don't count abstentions as votes against	0	0	2	0	0		0	0	0	1	1	0	0	2
Disclose shareholder sponsor	0	0	0	0	5		0	0	0	0	0	0	5	5
<i>Antitakeover issues</i>														
Rescind poison pill	20	26	18	17	2		28	17	15	13	9	0	1	83
Opt out of state antitakeover law	0	0	5	1	4		0	0	4	3	3	0	0	10
Anti-greenmail	0	0	1	2	0		0	2	1	0	0	0	0	3
Golden parachute	0	0	0	2	0		0	0	1	1	0	0	0	2
Targeted share placement	0	12	0	0	0		0	0	0	2	5	3	2	12
<i>Board of Directors issues</i>														
Shareholder advisory committee	0	0	6	0	0		0	0	1	2	2	0	1	6
Majority of outsiders on board	0	0	1	0	6		0	0	0	0	2	2	3	7
Majority of outsiders on compensation committee	0	0	2	0	5		0	0	0	0	2	1	4	7
Separate chairman and CEO	0	0	2	0	4		0	0	0	0	0	1	5	6
Independent nominating committee	0	0	0	0	4		0	0	0	0	0	0	4	4
Total	22	54	47	28	115		29	30	50	50	46	22	39	266

Table 2
 Activist pension fund holdings in target firms (1986–1994)

This table reports summary statistics on pension fund holdings based on quarterly 13F filings from June 1986 to June 1994. The New York City funds are omitted from this table because they do not file 13F filings directly. Instead, their holdings are reported by their external managers. The targeting date is defined as the quarter of the proposal's outcome, which is typically the annual meeting date. Since many firms are targeted multiple times, the table below specifies whether the statistics are relative to the first or last targeting. Values in brackets are medians

	SWIB	CALPERS	CALSTRS	CREF
Average total domestic equity portfolio value (\$ millions)	9,400	19,000	12,700	31,800
Average number of total stock holdings in the portfolio	576	1,112	3,739	1,767
Number of unique targets (1986–1994)	17	35	17	32
Percent of portfolio value in all target firms in year before first targeting	12.64	6.94	3.48	7.85
Total dollar investment in target firms in year before first targeting (millions)	939	1,130	422	2,151
Average dollar holding in target firms in year before first targeting (millions)	55.3 [51.4]	34.2 [25.5]	24.8 [9.9]	67.2 [67.5]
Average percentage ownership stake in target firms in year before first targeting	2.3 [1.6]	1.0 [0.7]	0.4 [0.4]	1.1 [1.1]
Average percentage ownership stake in year after last targeting	0.4 [0]	0.7 [0.6]	0.5 [0.4]	1.0 [1.0]
Average percent of portfolio invested in target firms in year before first targeting	0.74 [0.60]	0.20 [0.18]	0.22 [0.08]	0.25 [0.24]
Average percent of portfolio invested in target firms in year after last targeting	0.34 [0]	0.17 [0.10]	0.19 [0.10]	0.28 [0.21]

retain effective voting control over 98.9% of the stock they hold, compared to 66.4% for the average institutional investor. Together, these numbers suggest that the funds in our sample have the potential to be influential in their portfolio companies, and thereby have an economic incentive to become active.

3. Variation in pension fund strategies, objectives, and economic incentives

Our approach to examining fund motivation and impact is to identify and incorporate the heterogeneity in our sample fund's activism objectives and investment strategies. We seek to examine whether the heterogeneous objectives

and strategies of the funds appear to be consistent with their own measures of success, and with the normative goal of fund value maximization. Given the aggregate nature of most tests, it is possible that this underlying heterogeneity is partly responsible for the lack of consensus in the literature on the effectiveness of public pension fund activism. In this section, we outline key sources of heterogeneity among funds. These differences could shed light on the observed behavior of funds and their impact on target firms.

One important source of heterogeneity is the extent to which a fund is passively indexed. Funds devoted to indexing do not have the ‘Wall Street Walk’ option of selling when displeased with stock price performance. Thus, relative to actively managed funds, indexed funds have an incentive to promote spillover effects that boost the performance of the stock market overall, rather than that of specific stocks. Publicity is one potentially effective tool in promoting such spillover effects, since it affects not only the direct target of a funds’ activism but also other companies who observe it. The threat of publicity might give funds leverage with target management, and might also motivate other companies to proactively improve their corporate governance structures without being explicitly targeted.

Although spillover effects are difficult to measure, anecdotal evidence suggests that the kinds of practices that pension fund activists have been promoting in individual targets are being adopted more broadly. For example, The Business Roundtable, an association of CEOs of large corporations, released a *Statement on Corporate Governance* in September 1997 that lists their recommendations on the best practices regarding governance issues. Several recommended practices in this report, including having a majority of independent directors on the board and only independent directors on key board committees (audit, compensation, nominating), were common topics of shareholder proposals in the early 1990s. The significance of this is best summed up in a *Business Week* report: ‘Indeed, the biggest news in the Roundtable’s report may be that once radical ideas about corporate governance are now firmly in the mainstream – and are accepted by a group made up of 200 CEOs of the nation’s largest corporations and headed by the chieftains of Caterpillar, Johnson&Johnson, Chase Manhattan, and General Motors’ (*Business Week*, September 22, 1997, p. 36).

Although we cannot unambiguously attribute these changes to the efforts of the pension fund activists, Hawley et al. (1994) provide additional anecdotal evidence that externality effects exist. They report evidence based on interviews with top CalPERS officials that nontargeted firms pay attention to CalPERS’ interactions with target firms: ‘Indeed, in the last two years, CalPERS has been solicited via telephone calls, letters, faxes, and personal visits from numerous CEOs of non-targeted firms (underperforming and well performing) seeking to open the lines of communications should the need arise to explain future problems in order to stay off CalPERS’ target list’. These observations suggest

that publicity can be an effective tool to promote broad, marketwide changes. Monks and Minow (1995) make a similar point: ‘Perhaps the public pension funds’ most significant contribution has been to make the world an uncomfortable place for a director of an underperforming company’.

Another source of heterogeneity is the internal versus external nature of fund management. Funds that delegate investment functions to external managers effectively disconnect their activism efforts from their investment actions, thus preventing them from profitably trading on any private information that results from their activism. This is important since a shareholder large enough to influence corporate management has access to a source of gains not available to an ordinary stock-picker. Maug (1998) and Kahn and Winton (1998) present formal models of a large shareholder’s choice between engaging in activism or selling the position. These models show that a shareholder influential enough to effect change can generate trading profits by buying shares at the low price that does not yet reflect the impact of the improvements. In other words, the initial monitoring actions of the shareholder are private information, and profits can be generated by buying stock prior to any publicity concerning the activism. Once the market learns of the intention to monitor (perhaps from observing a very large stake), the free-rider problem comes into play since the influential shareholder must buy additional shares at the higher price. Thus, unlike an index fund, an internally and actively managed fund would have little incentive to publicize its activism efforts.

Table 3 provides summary information about the organization, investment strategy, and activism goals of each of the funds in our sample, as revealed to us in telephone interviews with key decision makers (full transcripts of the interviews are available from the authors by request). The funds have similar governance and oversight systems in that they each have investment and activism programs developed and implemented by fund staff and overseen and approved by boards of trustees. There are, however, substantial differences across the funds in investment strategy, goals of proposals, definitions of successful proposals, and views on using publicity.

The funds range from mostly indexed (CalPERS, CalSTRS, CREF, and NYC) to almost entirely active stock picking (SWIB). The California and NYC funds invest heavily through outside money managers, while SWIB and CREF have very active in-house investment analysts. Even though CREF is 80% indexed, they tend to take large bets with the remainder of the fund. This is confirmed in a *Wall Street Journal* interview of Douglas Dial, CREF’s in-house money manager, who reports that 16% of CREF’s portfolio is devoted to taking big stakes in 100 to 150 companies (April 4, 1995, p. C1). A more recent story on the Dow Jones newswire titled ‘\$100 Billion Fund: Indexing Plus Stock Picking Pays Off’ also confirms these numbers (October 20, 1997). Unlike the funds that invest through outside managers, CREF retains discretion over their non-indexed stock positions, which would allow for profitable trading in stocks that

Table 3
Summary of pension fund organization and activism objectives

This table is a summary of telephone interviews with senior decision makers at the funds, using a standardized set of questions (conducted February and March 1997). In the case of CALPERS we conducted the interview with the decision maker during the sample period, rather than the current decision maker

	CALPERS	CALSTRS	CREF	NEW YORK CITY	SWIB
	Richard Koppes, former Chief Counsel	CEO, Janice Hester-Amey, Corporate Affairs Advisor	Peter Clapman, Chief Counsel, Investments	Jon Lukommik, Deputy Comptroller	Kurt Schacht, Chief Counsel
Organization	BOT a mix of governor appointees, beneficiary reps, and elected officials. Chief Counsel staff proposes activism plan, BOT discusses and approves.	BOT a mix of governor-approved appointees and elected officials. Governance policies set by Investment Committee, ratified by BOT, and implemented by staff.	100% beneficiary-elected BOT. Chief Counsel staff recommends activism program, BOT reviews and approves.	Five plans with separate BOTs, each with a mix of political appointees and elected officials. Comptroller oversees activism policies for all plans. Staff recommends policy, BOT approves.	BOT a mix of governor and beneficiary appointees. Chief counsel staff recommends activism programs, BOT approves.
Investment strategy:	All equities externally managed, with full discretion to fund managers. 80% indexed, 20% active. Activism is not linked to buy/sell decisions.	All equities externally managed, with full discretion to fund managers. Largely indexed. Activism is not linked to buy/sell decisions.	All equities managed internally. 80% indexed and 20% active. Post 1995 may link trading and governance issues, pre not.	Externally managed and heavily indexed. Voting rights retained by funds. Activism is not linked to buy/sell decisions.	Active internal management with value investing focus in 80% of portfolio. 20% in externally managed index funds. Activism is not linked to buy/sell decisions.

<p>Objectives proposal activity:</p>	<p>Initially to get management's attention. As CALPERS became better known, proposals used as leverage to encourage action and shareholder value focus. More generally to 'raise the ocean in order to lift our boats'.</p>	<p>To draw attention to the poor performance, get a better understanding of the company and its long-term strategy. 'Never interested in putting a company in play' since they typically own the acquiring firm as well.</p>	<p>To have the specific request adopted. Believe eventually governance structure affects performance. Productive dialogue on governance issues and better relations with portfolio companies are side benefits of proposals.</p>	<p>'To make money'. Two ways: 'raise all boats' by changing corporate governance environment; change governance structure and shareholder value focus of specific companies.</p>	<p>To have the specific request adopted. Believe a good governance structure will affect performance over the long term. However, proposals are a secondary tactic to simply selling stock.</p>
<p>Why proposals?</p>	<p>'Nothing rivets the attention of the corporate mind like a proposal'. Currently use only if initial discussions with management unproductive. Proxy contests are too expensive.</p>	<p>Chiefly because of the low cost. Already own target stocks due to indexing. Do not wish to expend great resources on something that does not initiate investment decisions.</p>	<p>Submitting proposals starts dialogue, has impact because shows prepared to take the issue to a shareholder vote. Proxy fights are almost always too expensive.</p>	<p>Prefer private discussions with management first, but 'use proposals if we think we need to'. Proxy fights and takeovers are too costly and would raise the specter of a political backlash.</p>	<p>To get additional shareholder input on the issue, which may influence resistant management to make requested change. Used only if management will not make changes after private communication.</p>
<p>What is success?</p>	<p>If the proposal passes; if it results in significant changes in the company (strategic plan, top management, visible attempts to increase shareholder value.) 'The topic itself is not the real issue'.</p>	<p>If receive at least 30% of the vote. If in-depth discussion with management on performance and strategy results in agreement on future signs of progress or completion.</p>	<p>When management adopts the requested change.</p>	<p>When management is responsive to improving the shareholder value focus of the company. Eventually, when performance improves. In some cases, when the requested change is made.</p>	<p>When the specific change is adopted, and the governance structure is improved. Believe translates into higher returns over the long term.</p>

Table 3. Continued.

	CALPERS Richard Koppes, former Chief Counsel	CALSTRS CEO, Janice Hester-Amey, Corporate Affairs Advisor	CREF Peter Clapman, Chief Counsel, Investments	NEW YORK CITY Jon Lukomnik, Deputy Comptroller	SWIB Kurt Schacht, Chief Counsel
What action taken if not successful?	Repeat the proposal the following year. Keep coming back.	Repeat proposals for another two years.	Repeat the proposal the following year. Sell decision unrelated to proposal's success, solely related to stock fundamentals.	Repeat the proposal the following year. Consider escalating tactics, such as publicity. Give up if seems counterproductive.	Repeat proposal or become passive if seems success is very unlikely. May sell stock if stock fundamentals dictate.
Target selection:	Initially, targeting was based on the governance issue. Primarily performance based after 1989, choosing from the bottom 50 performers in their portfolio. Also consider size of own stake and specific governance issue.	In early years, purely by the governance issue, picking poor governance practices. Performance based after 1989. Also consider governance structure, insider and institutional ownership, and size of own stake.	Based on the specific issue. If feel a specific issue is important, look through their holdings to see which companies have that problem. Also look at size of stake and institutional ownership.	Originally based on the specific governance issue. Later included performance considerations.	Choose targets from the 'worst of the worst' in the portfolio, then look for governance issue to target. Only target if potential upside and structural issue to fix.
View on publicity:	Publicity can be an immensely powerful tool to get leverage with management, especially if egregious governance problems exist. Press has helped promote change.	Publicity is the greatest solicitation and education tool available, and is low cost. More awareness of the fund is created, but fund officials do not benefit personally from publicity.	Prefer not to use publicity, but will bring the issue to a vote if management won't adopt requested change.	Used publicity before gained reputation, but now start with private discussions and only use publicity when necessary (as escalating tactic). 'Goal is to effect change, not to get attention'.	Prefer not to use publicity; uncomfortable with having a higher profile. Publicity is another leverage on management, but is often unnecessary. Objective is to improve performance, not to get attention for individuals.

are targets of activism. Given that CREF is largely indexed but also devotes a significant dollar amount to active management, it is unclear whether they might behave more like the indexed funds or more like SWIB. In order to make this assessment, we must consider not only the results on activism and publicity strategies analyzed here, but also CREF's trading strategies analyzed in a later section.

The funds' stated views on publicity and definitions of targeting success are generally consistent with our earlier predictions. The heaviest users of indexing and outside managers (CalPERS, CalSTRS, and NYC) feel strongly that publicity is a useful and effective activism tool. Their stated goals include changing the governance environment and encouraging a shareholder focus in portfolio companies. They feel their campaign is successful if it results in change (rather broadly defined) at the company. For these funds, the topic of the proposal itself is not as important as generating a response from management, possibly in the form of a change from previous strategies or company direction. In contrast, the funds with investment strategies conducive to coordinating activism and trading efforts, SWIB and CREF, state that their immediate goal is to have the specific measure in the proposals adopted. Both state a belief in a link between governance structure and individual stock price performance. Both are very reluctant to use publicity, and do so only as a necessary last resort to make credible their threat to take the issue to shareholders. SWIB and CREF's avoidance of publicity and their narrow, firm-specific goals for activism seem consistent with the value-maximizing strategies outlined in the formal models discussed earlier. SWIB also states that they often choose to sell their stake rather than intervene, increasing the uncertainty as to whether they will monitor a given firm. As the models predict, this improves their ability to generate trading profits from their monitoring.

Differences in investment strategies and activism goals will likely carry over into proposal topic selection as well. Specifically, we might expect that funds with narrow activism goals, such as the internally and actively managed funds, would sponsor proposals that require greater firm-specific knowledge. Conversely, funds with broad, marketwide goals might tend to sponsor proposals that are more generically good for shareholders. Data from Table 1 on proposal topics broken down by sponsor generally support these predictions. For example, 91% of SWIB's proposals are on the topic of poison pills, while 70% of NYC's proposals request confidential voting. While most agree that confidential voting is good for shareholders since it mitigates management's influence on voting outcome, the benefits of poison pills are more firm-specific. For example, Brickley et al. (1994) find that poison pills announced by companies with a majority of independent outsiders on their board generate significant positive abnormal returns, while those announced by companies without such a majority generate significant negative abnormal returns. Consistent with this reasoning, John Lukomnik of the heavily indexed NYC fund reports that they do not

sponsor poison-pill proposals because they ‘require too much company-specific knowledge’. In contrast, Kurt Schacht at the actively managed SWIB tells us that ‘SWIB has always had a focus on antitakeover issues’. He stresses that their choice of targets is based on detailed knowledge of the companies, and that proposals are a secondary option to selling the stock.¹

The funds also differ in whether they tend to choose poorly performing firms as targets. Based on the prior five-year buy-and-hold stock returns, CalPERS, NYC, and SWIB tend to do performance-based targeting, while CREF and CalSTRS do not. Specifically, the median five-year stock returns for targets, in excess of the S&P 500, are –97% for CalPERS, –87% for NYC, –72% for SWIB, 4% for CREF, and 19% for CalSTRS. Thus, whether or not a fund does performance-based targetings does not seem to be related to its investment strategy. Even though we might expect both types of funds to choose poor performers, there are plausible reasons why they might focus on other criteria. We might expect actively managed funds to target poor performers since those are the firms with room for improvement and hence higher trading profits. The fund might also intervene, however, because they know that the firm is about to do worse. We also might expect funds with marketwide goals to choose poor performers since those are more likely to attract press attention or have a more receptive target management. However, they may also target a firm with good past performance but with a governance structure that could lead to future problems. For example, despite strong past performance, Disney was recently criticized for lacking independent directors that are not beholden to their CEO, Michael Eisner. Consistent with this reasoning, Hermalin and Weisbach (1998) in a formal model of board monitoring show that CEOs with substantial bargaining power, such as those with an exceptional performance record, are less likely to be scrutinized or disciplined by the board or to increase the number of independent directors.

Overall, activist pension funds show heterogeneity in their objectives for proposal activity, their propensities to use publicity, and their definitions of targeting success, each of which is sensibly related to their investment strategies. For example, the externally managed index funds that benefit most from activism strategies that ‘raise all boats’ state broader goals of corporate change. In contrast, the internally managed funds that have the flexibility to buy and sell target stocks have the more narrow goal of having the target firm make the specific change requested in the proposal. Despite their apparent similarities, large non-corporate pension funds are not a homogeneous set of investors.

¹ One exception to the predictions outlined here is CalSTRS’ choice of proposal topics. Given that they are heavily indexed (with their active portion externally managed), we might expect them to primarily choose proposal topics that do not require firm-specific knowledge. However, 79% of their proposals are on antitakeover issues.

4. Measuring the impact of shareholder proposals on target firms

As we turn to the empirical analysis, one issue is how to determine whether a proposal is successful or effective. Some possible definitions are whether the proposal receives more than 50% of shareholder votes, whether management takes the action requested in the proposal, or whether the proposal generates statistically significant abnormal returns at the announcement date. These definitions are similar to those proposed by SWIB and CREF as well as those used in the activism literature. For example, Karpoff et al. (1996), Wahal (1996), and Gillan and Starks (1998) examine stock returns around announcement dates of shareholder proposals and generally find no significant abnormal returns. However, as we discuss in Section 5, substantial event date uncertainty and other problems can erode the ability of an event study to detect the impact of proposals.

An alternative measure of the impact of proposals is whether the managers of target firms make significant changes in corporate policies or whether proposals appear to mobilize support for further governance activity such as takeovers. This is the explicit objective of CalPERS, NYC, and CalSTRS. Similar issues have been examined for proxy contests. Dodd and Warner (1983) find that insurgents win control of the board in only 25% of proxy contests, leading Shleifer and Vishny 1986, p. 472, to conclude that these governance mechanisms are ‘not effective’. However, DeAngelo and DeAngelo (1989) examine changes at companies following proxy contests, and find extensive turnover, asset sales, mergers, liquidations, and other major changes, even in companies at which proxy contests are deemed unsuccessful.

4.1. Analysis of changes in corporate policies following shareholder proposals

In this section we provide evidence that pension fund activism has a significant impact on target company business policies, organization, and governance. To measure the impact of proposal activity, we examine data on changes in management policy and significant events in the life of a corporation and compare these to data for a control sample with similar performance, size, and industry characteristics. We present analysis for the sample as a whole, as well as of subsamples of proposals by fund sponsor, topic, and voting outcome. We show that the heterogeneous objectives and tactics of the funds are reflected in target management’s response to a shareholder proposal, and that even proposals that do not receive a majority of votes are effective in promoting change.

We examine data collected from *The Wall Street Journal Index* on news of significant corporate events, either control-related (e.g., hostile tender offers) or those that might indicate managerial responses or significant corporate change (e.g., restructurings, turnover, changes in payout policy, employee layoffs). We

collect news starting with the first announcement of a proposal and continuing for a total of four years, event years 0 to +3.

We collect news event data over the same time period for a control sample matched to the targets on size, industry, and performance in the fiscal year-end prior to the first targeting announcement. We match on accounting performance, defined as operating income over assets, because poor performers are more likely to experience control changes and corporate restructuring related activities. We match on market capitalization and two-digit SIC industry codes because our test relies on corporate events being announced in *The Wall Street Journal*, and we expect that similar size firms in the same industries are likely to get similar coverage. The median operating income/assets ratio is 0.152 for both target and control samples; the median market capitalization is \$2816.7 million for targets and \$2257.1 for control firms. Of the 125 firms receiving proposals, 80 could be matched with control firms. Most of the target companies for which matches are not found are in industries such as retailing and defense that are dominated by a few major companies, almost all of which receive shareholder proposals during the period under study.

We test whether the target sample experiences a greater frequency of announced events than the control sample, employing the nonparametric Mann–Whitney U test for significance. (The Mann–Whitney test is equivalent to the Wilcoxon rank sum test but allows for different sample sizes in the distributions being compared.) Since we are testing for a greater frequency of announced events in the target sample, we conduct a one-tailed test. To check whether the results are driven by those targets without matching control firms, we conduct separate tests for the sample as a whole and for only those targets with matches in the control sample.²

Table 4 shows the frequency of several categories of corporate events for (1) our entire target sample, (2) those targets with matches, and (3) the control sample. Since the sample sizes differ across these three groups, we report the frequency of events on a per-firm basis. For example, there are 0.4 announcements per firm of CEO turnover in the target sample in the four years following the first announcement of a proposal, or equivalently 0.1 per year. Thus, 10% of target firms per year experience CEO turnover on average, versus 7.5% of control firms per year. CEO turnover in the target sample is not statistically different from the control sample. Karpoff et al. (1996) and Smith (1996) also find CEO turnover to be unrelated to the previous submission of a shareholder

² Additionally, we collect news up through three years from the *final* targeting for those companies targeted multiple times and repeat our tests using this longer period, with very little change in results. We also repeat the tests defining year 0 as the year of the last proposal. There are fewer differences and lower levels of significance. Thus, first-time proposals appear to have the greatest impact, and the impact of some proposals can take several years to develop.

Table 4

Frequency of announced events per firm in the four years after the first targeting

This table contains the post-targeting frequency of events per firm of several categories of corporate events announced in the *Wall Street Journal*. Frequencies per firm are given for our sample of firms that have received one or more shareholder proposals (target firms), and for a control sample matched by size, two-digit industry code, and accounting performance. In 45 cases we could not find a match that fit our stated criteria, so we also include the frequencies for the subsample of target firms that have matching control firms. The numbers in parentheses are the test statistics of the nonparametric Mann–Whitney U test. A negative and significant test statistic indicates that the distribution of news events in the target sample is significantly to the right of the control sample (*, **, and *** indicate statistical significance at the 10%, 5%, and 1% levels for a one-tailed test)

News categories:	Frequency of announced events per firm		
	All targets (<i>N</i> = 125)	Targets with matches (<i>N</i> = 80)	Control firms (<i>N</i> = 80)
Turnover	1.22*** (− 3.09)	0.91*** (− 2.36)	0.56
CEO turnover	0.40 (− 0.87)	0.38 (− 0.66)	0.29
Other turnover	0.82*** (− 2.81)	0.54** (− 1.90)	0.28
Hostile control attempt	0.22 (− 1.23)	0.20 (− 0.99)	0.06
Hostile control change	0.08 (− 0.97)	0.09 (− 0.96)	0.01
Any control attempt	0.38 (− 1.24)	0.38 (− 1.16)	0.14
Any control change	0.10 (− 0.35)	0.13 (− 0.55)	0.08
Governance events	0.52*** (− 2.37)	0.48** (− 2.09)	0.14
Management response	3.46*** (− 2.90)	3.38*** (− 2.74)	2.33
Payout Increase	2.26 (0.68)	2.35 (0.31)	2.40

News category definitions:

Turnover: CEO retires, CEO resigns unscheduled, director resigns, or other top executive resigns.

CEO turnover: CEO retires or CEO resigns unscheduled.

Other turnover: Director resigns, or other top executive resigns.

Hostile control attempt: a proxy contest attempt or hostile takeover bid.

Hostile control change: Win seat(s) in a proxy contest, hostile bid successful, or management buyout.

Any control attempt: a proxy contest attempt, hostile takeover bid, or merger talks.

Any control change: Win seat(s) in a proxy contest, hostile bid successful, management buyout, or merger completed.

Governance events: Shareholder lawsuit, a non-pension-fund-sponsored shareholder proposal, or public 'no' vote for directors.

Management response: asset sales or spinoff, restructuring/reorganization, or employee layoffs.

Payout increase: increase in dividends, repurchase shares.

Table 5
 Summary of the results of the Mann–Whitney rank sum test across various subsamples of target firms (events occurring within three years of the first targeting)

This table contains the test results of comparing the post-targeting frequency of several categories of corporate events announced in the *Wall Street Journal* in target firms relative to a control sample matched by size, two-digit industry code, and accounting performance. We employ the nonparametric Mann–Whitney *U*-test. Appendix A contains disaggregated results of individual corporate event announcements. Statistical significance indicates that the distribution of announced events in the target sample is significantly to the right of the control sample (*, **, and *** indicate statistical significance at the 10%, 5%, and 1% levels for a one-tailed test). Proposals included under the proposal type subsamples (voting, antitakeover, and board issues) are listed in Table 1. An observation is put in the multiple-type category if the firm receives multiple proposals in different proposal categories. An observation is put in the 1987 to 1989 or 1990 to 1993 subsamples if all proposals at that firm are in those years. Otherwise, they are put in a third date category (not reported). Outcome refers to the voting outcome of the proposal

News categories	Fund sponsor			Proposal type			Date			Outcome				
	SWIB	CREF	CALPERS	CALSTRS	NYC	Anti-takeover	Voting	Board issues	Multiple type	1987 to 1989	1990 to 1993	Passed	With-drawn	Failed
Turnover	***		**	**	**			***		**	***	*	**	**
CEO turnover	***		**	*	*	*		**		***	*		**	**
Other turnover	***		**	*	*	*		**	*	***	*		**	**

proposal in their samples. There are, however, other notable events that occur with significantly greater frequency in the overall target sample.

The target sample experiences greater turnover in top management (CEO or other senior executive, typically a CFO or president of a corporate unit), more noncontrol governance events (shareholder suits, non-sample proposals or letters, and 'no' votes for directors), and greater management response (asset sales, restructuring, reorganizations, and layoffs) than the control sample, at the 1% significance level. For example, the target sample has 0.52 noncontrol governance events on average in the four years after the first targeting. In contrast, the performance-, industry-, and size-matched control sample experiences only 0.14 such events. The target sample experiences 1.22 senior management turnovers and 3.46 management response events, compared to 0.56 and 2.33 for the control sample.

Table 5 summarizes significant differences in the frequency of announced events between subsamples of target firms and their matched comparison firms. We conduct the Mann–Whitney tests comparing the frequency of news events for subsamples of fund sponsor, proposal type, calendar date, and voting outcome. Among all the fund sponsors, CalPERS is the one most associated with subsequent changes at target firms. The subsample of CalPERS targets has significant differences from the control sample in five of ten news categories, including turnover, control attempts, noncontrol governance events, and management response. CalPERS is the only proposal sponsor associated with a higher frequency of announced external control attempts. Appendix A supplements Table 5 by showing a finer breakdown of news events and shows that CalPERS targets experience significantly more voluntary internal changes, in addition to events associated with external monitoring or control threats. For example, internal changes with a higher frequency of announcements include senior executive turnover, asset sales, voluntary restructurings, and layoffs.

As evidence of heightened external monitoring, CalPERS targets have a greater frequency of shareholder lawsuits, block purchases, and hostile takeover defenses. In analysis conducted for robustness checks, we find that CalPERS also has the most immediate effect of all the funds, with many significant differences occurring in as few as two years after the first news of the proposal (year 0 to year + 1). Repeating the tests for the subsamples of CalPERS targets that do and do not subsequently experience control activity provides an interesting insight. Only in the noncontrol activity subsample is there evidence of voluntary management response. For example, this is the only subsample to have a significantly greater frequency of voluntary restructurings and reorganizations, whereas hostile takeover defenses were only significant in the control activity subsample. This suggests that poorly performing firms that do not respond to shareholders such as CalPERS by making significant voluntary changes are more likely to become takeover candidates.

NYC and CalSTRS are the only other sponsors whose targets are associated with significantly greater changes, albeit for fewer event categories and with lower statistical significance. The three funds who in their interviews indicated broader ‘company response’ goals for their activism appear to be successful in eliciting a response from corporate management. It is not surprising that CalPERS is the most successful among these three since they have the largest ownership stakes, and arguably the highest profile. (According to the January 23, 1995 issue of *Pensions and Investments*, CalPERS had \$78.5 billion in assets, CalSTRS \$48.5 billion, and NYC \$35.3 billion at the end of 1994.) Perhaps the clout of the size of their stake, or the credible threat of publicity, makes managers more responsive to them.

At the other extreme, SWIB and CREF do not seem to generate significant activity in their target firms. These funds’ main objective is for the target firm to make the specific change requested in the proposal. Wahal (1996) reports that 43% of SWIB’s requests are adopted by corporate management. Carleton et al. (1998) report that ‘CREF was able to convince the firms to enact the changes it desired in 69 of 72 firms (95.8%) during our 1987–1996 sample period’. Note that in some cases it takes several years of targeting for CREF’s target companies to make the requested changes. Although they are generally successful by their own measure, they do not seem to generate a broader response from corporate management. One possibility is that corporate managers are less receptive because they view these funds as less permanent shareholders than the three externally managed index funds, an idea explored later in this study.

Table 5 also shows results by proposal type. In this analysis, a target is in a proposal category if all proposals received by a firm are related to that same category. If a target, for example, receives both voting and antitakeover proposals, they would be in the multiple type category. We expect voting-related proposals to have the least impact as the subject matter is relatively benign, and those relating to the board of directors to have the greatest impact as they embody more direct intervention by shareholders in governance and management processes. The results are consistent with these predictions. Specifically, firms targeted with board-related proposals have significantly greater announcements of CEO turnover, non-CEO turnover, management response, and noncontrol governance events than the control sample, while voting proposals are only associated with greater non-CEO turnover at the 10% level. Targets of board-related proposals are the only subsample to have significantly greater CEO turnover. Antitakeover proposal targets are the only proposal category associated with greater announced control change attempts.

In a comparison of events in target firms by voting outcome, Table 5 shows that even proposals that fail to get a majority of voting support are associated with significant changes at target firms. Specifically, failed proposals are associated with higher turnover and management response, such as layoffs. Target firms in which a shareholder proposal is withdrawn by the sponsor, usually in

Table 6
Further tests on announced events per firm

This table contains the frequency of events per firm in the same categories of corporate events as in Tables 4 and 5. The first two columns replicate the results in Table 4 for ease of comparison. The next two columns of results are for a 61-firm subsample of the original 125-firm sample. This subsample removes the 25% of firms with control firms considered ‘poor’ matches on previous five-year buy-and-hold stock returns. The Pearson correlation between stock returns of the targets and controls in this subsample is 0.78, and the distributions of returns are very similar. The last four columns of results compare the frequency of corporate events in the four years after targeting to the four years before targeting for a 69-firm subsample of the original target sample of 125 firms. Firms are selected for this subsample analysis if the firm name starts with the letters B through M. The last two columns of results compare the frequency of corporate events in the four years after targeting to the four years before targeting for a 44-firm subsample of the original control sample of 80 firms. Firms are selected for this subsample analysis if they are a control firm for a target firm with a name starting with the letters B through M. As in Table 4, the numbers in parentheses are the test statistics of the nonparametric Mann–Whitney *U*-test. A negative and significant test statistic indicates that the distribution of news events is significantly to the right of the corresponding control sample (*, **, and *** indicate statistical significance at the 10%, 5%, and 1% levels for a one-tailed test)

News categories:	Table 4 results comparing targets that have matching controls		Close matches on previous five-year buy- and-hold stock return		Target sample		Control sample	
	Targets (<i>N</i> = 80)	Controls (<i>N</i> = 80)	Targets (<i>N</i> = 61)	Controls (<i>N</i> = 61)	After targeting (<i>N</i> = 69)	Before targeting (<i>N</i> = 69)	After targeting (<i>N</i> = 44)	Before targeting (<i>N</i> = 44)
Turnover	0.91*** (-2.36)	0.56	1.03*** (-2.56)	0.59	1.26 (0.26)	1.12	0.57 (0.42)	0.55
CEO turnover	0.38 (-0.66)	0.29	0.46 (-1.23)	0.30	0.35 (-0.33)	0.30	0.34 (-0.55)	0.27
Other turnover	0.54** (-1.90)	0.28	0.57** (-1.84)	0.30	0.91 (0.27)	0.81	0.23 (0.69)	0.27
Hostile control attempt	0.20 (-0.99)	0.06	0.18 (-0.80)	0.05	0.25* (-1.50)	0.04	0.07 (-0.17)	0.07

Hostile control change	0.09 (-0.96)	0.01	0.08 (-0.62)	0.02	0.10 (-1.18)	0.00	0.00 (0)	0.00
Any control attempt	0.38 (-1.16)	0.14	0.39 (-0.99)	0.15	0.38** (-1.64)	0.10	0.14 (0.18)	0.16
Any control change	0.13 (-0.55)	0.08	0.13 (-0.62)	0.07	0.15* (-1.47)	0.00	0.05 (-0.37)	0.00
Governance events	0.48** (-2.09)	0.14	0.48* (-1.63)	0.13	0.46** (-1.72)	0.23	0.11 (-0.18)	0.11
Management response	3.38*** (-2.74)	2.33	3.56** (-2.28)	2.48	3.35** (-1.93)	2.36	2.05* (-1.47)	1.30
Payout increase	2.35 (0.31)	2.40	2.20 (0.44)	2.30	2.35 (1.21)	2.80	2.66 (-0.68)	2.39

exchange for concessions by the firm's management, also have significantly greater governance and management response events, the latter primarily announced asset sales. However, high shareholder support does seem to be related to control activity, the most dramatic form of corporate change. Appendix A shows that passed proposals are the only outcome category associated with greater announcements of control activity such as proxy contests, hostile defenses, merger talks, and block purchases.

4.2. *Further tests on announced firm activities associated with pension fund proposals*

The results in Tables 4 and 5 indicate that there is a significantly higher frequency of corporate activity in firms targeted by our sample pension funds relative to a control sample matched on two-digit industry codes, market capitalization, and accounting performance. In this section, we investigate whether these results can reasonably be linked to intervention by pension funds rather than our failure to control for a relevant variable. For example, if pension funds choose targets that are likely to engage in the organizational changes we measure, we might mistakenly attribute such changes to the targeting activity. We conduct two sets of robustness checks on our results. First, we examine a subsample of target firms for which the previous five-year buy-and-hold stock returns match closely with their size- and industry-matched control firm. This addresses the concern that the results are driven by poor stock performers that *a priori* are more likely to experience events such as control activity and management changes. Second, we compare the frequency of events before and after targeting for a subsample of targets and matching control firms. This addresses the concern that our results are driven by differences in reporting by *The Wall Street Journal* for the target and control samples, or alternatively, that pension funds simply target 'high-activity' firms.

Table 6 contains the results of the additional tests, using the same format and variables as Table 4. For ease of comparison, the full sample results of Table 4 are repeated here. For the first test, we repeat the analysis on the 75% of matching control firms that also match closely on previous five-year stock returns. (The results are also robust in a subsample analyzing the 50% of the sample with the closest match in stock returns.) Within this subsample of 61 firms, the distributions of stock returns for targets and controls are very similar, and the correlation between the returns of targets and controls is 0.78. This test indicates that our results are not likely to be driven by poorer stock performance at target firms. The results are quantitatively similar to the full sample, with similar levels of statistical significance. Furthermore, the subsample analysis by sponsor is also very similar to the results in Table 5.

For the second test, we compare the frequency of announcements in the four years before targeting to the four years after targeting for a subsample of targets

and for control firms. This is similar to the method used by Huson (1997) to analyze CalPERS' targets. To select a representative sample from our original 125 targets, we conduct this subsample analysis on a total of 69 target firms with names beginning with the letters B through M. Of these 69 firms, 44 have matching control firms. The last four columns of Table 6 show that the only significant increase in activity for the control sample from the period before to after targeting is in the management response category (asset sales, restructuring, reorganizations, and layoffs). In contrast, the target sample experiences significantly higher frequencies of activities in five of the ten categories. Interestingly, the only event that is significantly more frequent in the period before targeting is the adoption of takeover defenses. This is true for both the target and control sample, although the frequency is higher for target firms.

Management turnover is not significantly different in the periods before and after targeting, but the governance events and management response results are robust to this additional test. Despite similar levels of corporate control activity in the before period for the target and matching control firms, we find a significant increase in control activity for the target sample only. Analysis by pension fund sponsor indicates that the results in Table 5 are also generally robust, with the exception of those for management turnover. CalPERS continues to be the most effective sponsor by this measure, and the only sponsor associated with increased corporate control activity. SWIB and CREF, the sponsors with the narrow goal of adoption of the proposal's specific request, continue to be associated with no significant company response in any category of event.

In sum, we find that shareholder proposals are associated with significant changes at target companies in that they are followed by both governance events and corporate policy changes. The impact of proposals is heterogeneous, but is consistent with the objectives of the funds. Specifically, the three funds who define success as an ability to promote change at portfolio companies appear to be successful by this measure. The pattern of events following proposals appears to be logically related to the proposal topic (e.g., takeover attempts follow antitakeover-related proposals), but less related to the amount of shareholder support received. The evidence also suggests that a proposal's impact might be through its inclusion in a series of reinforcing corporate control events, a result we explore further below.

4.3. Further analysis of post-targeting control activity in target firms

One view of the role of shareholder proposals is that they serve to mobilize support for more costly governance activity such as takeovers. This view is expressed by former SEC commissioner Sommer (1992):

Moreover, a substantial vote in favor of a shareholder proposal opposed by management might be seen as a vote of 'no confidence' in management and

stir the juices of would-be ‘raiders’, either proxy or takeover variety. Indeed, some managements have expressed the notion that a twenty percent favorable vote on a shareholder proposal is extremely disquieting to management.

In this section we look more closely at the hypothesis that shareholder proposals are precursors to subsequent control activity. A hostile control change (tender offer or proxy contest) is attempted within three years of the first targeting in 16% (20 out of 125) of target firms and is successful 50% of the time (ten out of 20 attempts). In contrast, only 6.3% (five out of 80) of control firms experience a control change attempt. Of these five, one is successful. Of the 27 target firms that subsequently experience control activity, 13 (48%) are CalPERS targets, 15 (56%) *exclusively* receive antitakeover proposals, 20 (74%) receive antitakeover proposals, and five (19%) have a passing proposal. Interestingly, although only 11 firms in the entire sample have passing proposals, five (46%) of these subsequently experience control activity. Similarly, one-third of SWIB’s and 37% of CalPERS’ targets subsequently experience control activity.

We investigate these suggestive univariate relationships more formally using a probit analysis, reported in Table 7. We classify all events with an attempted or successful change in control as hostile or nonhostile, based on a reading of articles in *The Wall Street Journal* about the control activity. Evidence of management resistance to the control change leads us to classify events as hostile. For our sample of proposal targets and matching control firms, we regress the indicator variable for control activity on a number of variables thought to be related to the probability of takeover. We use the same control variables as Comment and Schwert (1995), including stock and accounting measures of performance, firm size, and sales growth. We also include dummy variables for whether the firm is in the target or control sample, whether it is a CalPERS target, whether it exclusively received antitakeover proposals, and whether it received a passing proposal.

We find that firms receiving exclusively antitakeover proposals, those targeted by CalPERS, and those with passing proposals are independently associated with a significantly higher probability of a takeover attempt after controlling for other variables related to takeover probability. These results support the view that strong shareholder voting support sends a message to ‘would-be raiders’, and perhaps suggests that CalPERS is viewed as a permanent shareholder that is likely to support a takeover bid.

Successful hostile takeovers are significantly positively related to the antitakeover proposal dummy, and negatively to sales growth. For successful control changes (both hostile and nonhostile), firm size is also significantly negatively related, in addition to sales growth and antitakeover proposals. In a related finding, Bizjak and Marquette (1999) report that corporate management is more likely to restructure (rescind or raise the flip-in trigger) its poison pill if a firm receives a poison pill proposal, especially one sponsored by a pension fund.

Although a dummy variable for SWIB's targets is not statistically significant in the regression, 100% of SWIB's proposals are antitakeover proposals. Interestingly, by analyzing ownership stakes in target firms, we find significant differences in SWIB's percentage owned at the proposal outcome in firms that subsequently experience control activity. Specifically, they own 4.7% on average of the control activity subsample and 1.5% on average of the rest of their targets, a significant difference at the 1% level. In contrast, there are no differences in ownership detected by separating CalPERS targets that subsequently experience control activity from those that do not.

5. Other measures of the impact of shareholder proposals on target firms

In this section we provide evidence on both short-term and long-term event study evidence on the valuation effects of shareholder proposals. This allows us to examine the wealth maximization hypothesis and to establish comparability to other studies. In addition, we investigate whether the results are consistent with heterogeneous fund objectives and with the evidence of the previous section. If pension funds are influential but pursue political objectives, we might expect to observe a reduction in firm value and operating performance upon targeting. Alternatively, we might expect to observe no valuation effects on average if proposals are value-neutral, or as we argue below, if traditional methods for measuring valuation effects are not powerful enough to capture a proposal's impact.

5.1. Short-term stock price effects

The first three columns in Panel A of Table 8 contain the results of an event study using the market model to estimate normal returns and the Center for Research in Security Prices (CRSP) value-weighted index as a proxy for the market.³ Market model parameters are estimated over the interval from 250 days through 50 days before the first news of a proposal. We report abnormal returns for three windows: the two-day period around the first news of a proposal, around the outcome, and in the period that includes both dates. The announcement date is defined as the earliest of a *Wall Street Journal* or *Lexis/Nexis* newswire announcement of a proposal, or the date of the proxy statement that contains the proposal. The outcome date is the annual meeting date, or news date of a withdrawn proposal.

³ The market model is a concern in this context since the targeted firms tend to perform poorly prior to targeting, so we repeat the event study using a simple market adjustment, with no changes in inferences. Our statistical tests use standard errors that take into account the serial dependence in forecast errors from cumulating abnormal returns using a single set of market model parameters, as described by Mikkelsen and Partch (1988).

Table 7
 Probit model regressions of corporate control activity on firm characteristics

This table presents the results of probit regressions that predict which firms will be subject to corporate control activity within three years of a shareholder proposal. The sample includes target firms and control firms as described in Table 4. The target dummy is equal to one if the firm is in our target sample and equal to zero for each matched control firm. The CalPERS dummy is equal to one if CalPERS is the sponsor and zero otherwise. The antitakeover proposal dummy is equal to one for target firms that exclusively received antitakeover proposals and zero otherwise. The passed proposal dummy is equal to one if the proposal passed with a majority of votes and zero otherwise. The remainder of the variables are as described in Comment and Schwert (1995). *P*-values are in parentheses (***, **, * indicates statistical significance at the 1%, 5%, and 10% levels)

	Dependent variables				
	Dummy equal to one if firm experiences a hostile takeover attempt	Dummy equal to one if firm experiences a successful takeover	Dummy equal to one if firm experiences any takeover threat	Dummy equal to one if firm experiences any control change including friendly merger	Coefficient
Intercept	Coefficient 1.097 (0.46)	Coefficient -0.300 (0.89)	Coefficient -0.264 (0.83)	Coefficient 2.111 (0.19)	
Target dummy	-0.400 (0.32)	-0.009 (0.99)	-0.610* (0.08)	-0.577 (0.18)	
CalPERS dummy	0.861*** (0.01)	0.723 (0.13)	0.735** (0.03)	0.467 (0.28)	
Antitakeover proposal dummy	0.909*** (0.01)	1.160** (0.03)	1.019*** (0.00)	1.070*** (0.01)	
Passed proposal dummy	1.055* (0.07)	0.742 (0.39)	1.145** (0.04)	-0.037 (0.96)	

Abnormal return (Prior four-year ave.)	- 75.725 (0.59)	- 29.437 (0.87)	- 55.824 (0.65)	44.091 (0.74)
Firm size ^a (in prior year)	- 0.204 (0.16)	- 0.166 (0.45)	- 0.065 (0.60)	- 0.407** (0.02)
Sales growth (Prior four-year ave.)	- 1.926 (0.22)	- 6.498** (0.04)	.018 (0.99)	- 4.323** (0.03)
Liquidity (Prior four-year ave.)	1.452 (0.28)	3.000 (0.15)	1.320 (0.26)	0.127 (0.92)
Debt/equity (Prior four-year ave.)	0.004 (0.99)	0.321 (0.46)	0.247 (0.40)	0.262 (0.45)
Market/Book (Prior four-year ave.)	- 0.359 (0.12)	- 0.323 (0.38)	- 0.214 (0.22)	0.119 (0.50)
Price/earnings (Prior four-year ave.)	- 0.024 (0.30)	- 0.034 (0.25)	- 0.019 (0.35)	- 0.023 (0.31)
Number of observations	175	175	175	175
Chi-square statistic (degrees of freedom)	25.19*** (11)	21.01** (11)	22.62** (11)	20.24** (11)

^aLog of total assets in year prior to first targeting.

Table 8

Short-term and long-term event study results at the announcement of a shareholder proposal

Panel A. Average abnormal returns for the entire sample and by sponsor, voting outcome, and proposal topic across four event windows

This panel contains average abnormal returns for the full sample and for subsamples by sponsor, proposal outcome, and proposal topic over four event windows. *P*-values are in parentheses and the percentage of positive CARs are in brackets unless otherwise noted. *, **, and *** indicate statistical significance at the 10%, 5%, and 1% levels. AD is the date of the first news that a target company will receive a proposal. OD is the earlier date of the annual meeting or the press announcement of withdrawal or resolution (negotiated outcome). For example: AD-20 to OD + 20 includes returns from 20 days before announcement date through 20 days after the outcome. '> 25%' and '> 50%' refer to percent of votes cast in favor of a proposal. 'Passed' means the proposal passed according to company bylaws (may require more than 50% of votes cast or 50% of all shares, including non-voted). 'Failed' means the proposal did not pass according to company bylaws. For proposals with identical event dates (e.g., both CalPERS and SWIB targeted IBM with different proposals on different topics), each sponsor and topic are credited with the proposal in the subsample results. However, the proposal is counted only once in the full sample results. For the short windows, we use the market model to estimate the parameters to calculate normal returns, and our statistical tests use standard errors that take into account the serial dependence created by cumulating abnormal returns calculated using a single set of market model parameter estimates, as described by Mikkelson and Partch (1988). For the long window, we compute mean buy-and-hold returns (BHAR) using the method of Barber and Lyon (1997). Specifically, BHAR is the simple average of compound target firm returns over the three years after the announcement of a proposal minus the simple average of compound control firm returns over this same period. That is, $BHAR_{i,T} = \prod[(1 + R_{it}) - \prod[(1 + R_{ct})]$, where $BHAR_{i,T}$ is the period *T* buy-and-hold return for security *i*, R_{it} is the monthly raw return for security *i*, and R_{ct} is the monthly raw return for the control firm

Window	AD-1 to AD Two-day announcement	OD-1 to OD Two-day outcome	AD-20 to OD + 20	Up to three years after
Full sample (1987–93) <i>n</i> = 224	– 0.0000 (0.8470) [48.7]	0.0007 (0.3889) [49.1]	0.0256 (0.3289) [51.8]	– 0.0352 (0.7426) [<i>n</i> = 73]
Sponsor:	Two-day announcement	Two-day outcome	(AD-20 to OD + 20)	Up to three years after
SWIB <i>n</i> = 20	– 0.00035 (0.9545) [55.0]	0.00804** (0.0241) [55.0]	0.07948 (0.1379) [65.0]	– 0.0995 (0.7226) [<i>n</i> = 9]
CREF <i>n</i> = 52	– 0.00152 (0.5727) [38.5]	0.00011 (0.9761) [48.1]	0.00988 (0.7148) [51.9]	0.0294 (0.8411) [<i>n</i> = 17]
CALPERS <i>n</i> = 40	0.00389 (0.3812) [50.0]	0.00852** (0.0268) [50.0]	– 0.01199 (0.9153) [50.0]	– 0.0646 (0.8039) [<i>n</i> = 20]

CALSTRS	0.00331	0.00222	-0.00845	-0.1587
<i>n</i> = 28	(0.9103) [53.6]	(0.3783) [42.9]	(0.5286) [39.3]	(0.5724) [<i>n</i> = 10]
NYC funds	0.00345	-0.00209	0.06945*	0.0961
<i>n</i> = 101	(0.3086) [51.5]	(0.5121) [52.5]	(0.0895) [54.5]	(0.5613) [<i>n</i> = 31]
<i>Outcome</i>				
Failed	0.00142	0.00128	0.02233	-0.0466
<i>n</i> = 200	(0.4648) [49.0]	(0.1657) [50.0]	(0.4480) [51.0]	(0.7092) [<i>n</i> = 52]
Passed	0.00815	0.00971	0.02442	0.3894
<i>n</i> = 11	(0.3989) [45.5]	(0.1250) [63.6]	(0.8745) [45.5]	(0.3214) [<i>n</i> = 6]
Negotiated/withdrawn	0.00109	-0.00362	0.05756	-0.0674
<i>n</i> = 16	(0.7302) [50.0]	(0.2063) [31.2]	(0.4077) [68.8]	(0.6015) [<i>n</i> = 16]
> 25% votes in favor	0.00142	0.00280**	0.01539	-0.0647
<i>n</i> = 171	(0.4648) [49.1]	(0.0425) [50.3]	(0.4140) [50.3]	(0.6700) [<i>n</i> = 49]
> 50% votes in favor	0.00815	0.01077**	0.02881	0.6403
<i>n</i> = 15	(0.3989) [46.7]	(0.0134) [60.0]	(0.6518) [40.0]	(0.1648) [<i>n</i> = 7]
<i>Proposal topic</i>				
Voting issues	0.00355	0.00010	0.00875	-0.1483
<i>n</i> = 111	(0.1028) [53.0]	(0.6025) [54.1]	(0.6392) [54.1]	(0.5350) [<i>n</i> = 21]
Antitakeover issues	-0.00247	0.00214	0.01066	-0.1945
<i>n</i> = 102	(0.1894) [44.1]	(0.2103) [42.2]	(0.7754) [47.1]	(0.2066) [<i>n</i> = 24]
Board issues	0.01325	0.00418	0.19359*	0.4567
<i>n</i> = 19	(0.1770) [47.4]	(0.6939) [63.2]	(0.0550) [57.9]	(0.2266) [<i>n</i> = 9]

Table 8. Continued.

Panel B. Announcement date average cumulative abnormal returns for proposals partitioned by whether the announcement date is earlier than or the same as the proxy statement date	
This panel contains the results of partitioning the sample according to when the market learns of the shareholder proposal. An announcement date earlier than the proxy statement date indicates that we are able to find a press announcement for the proposal prior to the proxy statement date. If we are unable to find a press announcement, the proxy statement date is the announcement date. <i>p</i> -values are in parentheses (*, **, and *** indicate statistical significance at the 10%, 5%, and 1% levels)	
Two-day announcement date cumulative abnormal returns	
	Announcement date < proxy date
Full sample	0.004 (0.1588) [51% positive] { <i>N</i> = 102}
1990 to 1993 proxy seasons only	0.008** (0.0455) [56% positive] { <i>N</i> = 61}
Antitakeover and board proposals only (excludes voting proposals)	0.004 (0.6178) [46% positive] { <i>N</i> = 48}
Antitakeover and board proposals in the 1990 to 1993 proxy seasons only	0.010 (0.1218) [53% positive] { <i>N</i> = 32}
	Announcement date = proxy date
Full sample	- 0.001 (0.6864) [45% positive] { <i>N</i> = 115}
1990 to 1993 proxy seasons only	0.001 (0.7695) [47% positive] { <i>N</i> = 60}
Antitakeover and board proposals only (excludes voting proposals)	- 0.005* (0.0517) [41% positive] { <i>N</i> = 64}
Antitakeover and board proposals in the 1990 to 1993 proxy seasons only	- 0.012* (0.0591) [19% positive] { <i>N</i> = 16}

There are three reasons why an event study methodology might not be powerful enough to capture the true impact of shareholder activism. First, there is substantial event date uncertainty for proposal announcements because only a minority are announced in the usual financial news sources such as the *Wall Street Journal*. Second, since the proposals are nonbinding and management's response to the proposal is unknown, uncertainty regarding the valuation effects of proposals continues over the long period between the announcement and outcome dates. For example, management might adopt the proposal even though it does not obtain a strict majority (in 1988 Gillette implemented a proposal relating to its poison pill even though the proposal did not receive a majority of votes), or might not adopt the proposal even though it does win a majority of votes (USAIR, also in 1988). Even if a proposal does not pass, a high percentage in favor can signal broader discontent with management and a call to further action. For example, SWIB tells us that in some cases management is totally unresponsive until their proposal generates significant support from other shareholders, at which point 'the board may look at it differently'. Thus, one view of proposals is that they are an inexpensive way to mobilize support or alert directors to oust incompetent managers.

Finally, we learn from the interviews that often a proposal is publicly filed only after private communications with target management have failed to satisfy the proposal sponsor. Since many pension fund proposals are successfully negotiated and withdrawn prior to the publication of the proxy statement, appearance of a proposal on the proxy can signal the bad news that management is unresponsive to shareholders. Thus, a negative stock price reaction to the announcement of a proposal might not necessarily be evidence that public pension funds are politically motivated. We provide some evidence consistent with this conjecture below.

Panel A of Table 8 presents the results for the full sample as well as for subsamples partitioned by sponsor, voting outcome, and proposal topic. Data on voting outcomes are from the IRRC Corporate Governance Service. Consistent with the results of other studies, we find little evidence that there are significant valuation effects for broad samples of proposals at the announcement of a shareholder proposal submission. The two-day announcement return for the entire sample of 224 proposals from 1987–1993 is not significantly different from zero. We find that none of the subsamples have significant returns in the announcement window, but CalPERS, SWIB, proposals receiving greater than 25% of votes, and proposals receiving greater than 50% of votes have positive significant abnormal returns in the two-day *outcome* window. With the exception of the result for SWIB, however, these results are sensitive to one outlier (Avon Corp.) that experienced a takeover bid within the outcome window. Targets of proposals on board-related issues exhibit positive and significant abnormal returns of 19.4% in the longer window encompassing the period between the announcement and outcome dates. This is consistent with the

results of our corporate news analysis, which finds board-related proposals to have the broadest impact.

Panel B of Table 8 contains results for the announcement date partitioned by when the market learns of the shareholder proposal. An announcement date earlier than the proxy statement date indicates that we are able to find a press announcement for the proposal prior to the proxy statement date. If we are unable to find a press announcement, the proxy statement date is the announcement date. We find that negative and significant announcement day CARs are concentrated in antitakeover and board proposals that have the first announcement on the proxy statement. Within this subsample, the CARs are even more negative on average in the 1990s when negotiated settlements became more common, which is consistent with the conjecture that the negative reaction is due to the market learning that negotiations failed. Proposals in the 1990s announced prior to the proxy statement have significantly positive abnormal returns. There is no difference in CARs from the proxy date or earlier dates for voting proposals, however, which we attribute to their relatively benign content.

5.2. *Long-term performance of targets*

As other studies argue, the benefits of activism might only be revealed over a long time period. We also investigate the long-run stock price performance of target firms relative to the control sample and relative to broad market indexes. We note that while long-term abnormal stock price performance is a desirable metric to capture, even the best methods are imprecise and should be interpreted with care. We calculate monthly buy-and-hold returns following the method recommended in Barber and Lyon (1997) for target and control firms through three years after the first announcement of a targeting, and test for significant differences between the two groups. The last column of Panel A of Table 8 shows that for both the full sample and subsamples by sponsor, outcome, and proposal topic, there is no evidence of abnormal returns.

We also compare the returns of our target sample to the S&P 500, an approach similar to Nesbitt (1994). We find, but do not report, that target companies generally have higher returns than the index, but not significantly higher, in the three years after targeting. We find the same result for our control sample of firms of similar industry, size, and performance, which leads us to suspect that the stronger performance Nesbitt attributes to CalPERS' targeting is due instead to mean reversion or a tendency to rebound from poor performance.

We also examine, but do not report, whether shareholder activism has an impact on the operating performance of target companies within three years of targeting. Using the method used in Karpoff et al. (1996), we investigate whether target companies rebound more quickly from poor performance by comparing

the accounting performance measures of our target sample to the performance-, industry-, and size-matched control sample described in Section 4. Specifically, we calculate operating income divided by assets (ROA) and operating income divided by sales (ROS) as well as sales and asset growth for four years, beginning in the year before the first targeting. Consistent with the findings of others, target firm performance does not rebound faster than that of performance-matched control firms.

Overall, we find few statistically discernible results from our analysis of stock and operating performance of target firms. Given the stated measurement difficulties and lack of power, however, this is not surprising. Thus far, we find no evidence to support the hypothesis that motivations other than fund value maximization are the impetus behind public fund activism. In the next section we provide further evidence on fund motivation.

6. Evidence on the normative goal of fund value maximization

In this section we discuss the alternative hypotheses to fund value maximization discussed in the literature, and provide some evidence that the funds' target selection and trading behavior does not appear to be consistent with these alternatives.

Romano (1993) and Murphy and Van Nuys (1994) maintain that agency problems within the funds themselves prevent them from being effective corporate monitors. They argue that managers of public funds may use their influence to further their own political or personal goals, instead of maximizing beneficiary wealth. For example, Murphy and Van Nuys predict that public pensions will tend to 'target high-profile companies, generating large nonmonetary rewards for the fund managers in the form of publicity (which in turn may affect their future employment opportunities)'. Others argue that the absence of activist private pension funds, or other types of institutional investors with superior incentive structures, is evidence that public funds have ulterior motives. There are, however, reasonable alternative explanations for these observations. As we have argued, the use of publicity might be part of an overall strategy for an index fund to maximize value. Further, other types of institutions, such as corporate pension funds, bank trusts, and insurance companies, might forgo activism because they are reluctant to appear openly antagonistic to management or to jeopardize business relationships with the firm. Anecdotally, in 1987, CEOs of seven Fortune 500 companies wrote letters to their fellow CEOs urging them to instruct their pension managers to vote against shareholder proposals (*Institutional Investor*, June 1988, p. 162.) Also, Pound (1988) finds that institutions such as banks and insurance companies are more likely to side with management in a proxy contest, possibly in order to ensure future business ties with the firm. Similarly, Van Nuys (1993), in a case study of a proxy fight at

Honeywell Corporation, finds that bank trusts and insurance companies are more likely to support management-sponsored antitakeover proposals than are public pension funds.

There is a growing literature that finds *indirect* evidence that activist funds are politically motivated. Based on a sample of Fortune 500 firms, Woitke (1996) finds a negative relation between firm performance (industry-adjusted Tobin's Q) and percentage ownership by activist public pension funds. Wagster and Prevost (1996) find that firms targeted by CalPERS have significantly negative stock price reactions to the announcement of the 1992 proxy rule changes. Johnson et al. (1997) find that a dummy variable for CalPERS 1992 'hit-list' firms is negatively related to both CEO compensation changes and pay-for-performance sensitivity changes, which they interpret as evidence that CalPERS acts more like a populist crusader against executive pay levels than a wealth-maximizing shareholder.

6.1. Target selection

We might expect a wealth-maximizing fund to choose targets for which there is a high probability of having an impact, garnering support from other shareholders, and recouping the return on investing in this activity. Of course, to assess returns from proposals one must consider costs as well as benefits. All five funds emphasize the cost-effectiveness of shareholder proposals. Their own estimates of the annual cost of their entire activism programs range from \$50,000 to \$1 million, which is less than half of a basis point for these funds.⁴ Given the substantial ownership stakes documented in Table 2, there appears to be ample economic incentive to become active. Even CalSTRS, the fund with the smallest investment in targets at \$422 million, has a strong incentive to submit shareholder proposals. If their monitoring activities were to improve stock prices a mere 0.5% at target firms, they could increase their portfolio value by \$2 million. There is, of course, an even greater incentive at the larger and more active funds.

The selection criteria, as described by the funds and confirmed by empirical studies, are arguably consistent with fund value maximization. During the early years of our sample, funds target firms based on the specific issue at hand, but later use poor performance as a criterion. The only exception is CREF, who still

⁴ Smith (1996) reports that CalPERS spends approximately \$500,000 annually on all activism activities. This represents only 0.002% of the value of their domestic equity holdings. Carleton et al. (1998) report that CREF spends \$1 million annually, or 0.002% of assets on its activism program. SWIB states to us in the interview that the cost of activism is 'a tiny fraction of our assets, not even a blip on our screen'. In contrast, Pound (1991) estimates the legal costs of soliciting support for a full-control proxy solicitation at \$1.5–3.5 million.

selects targets on the basis of specific issues (e.g., if a portfolio company implements a poison pill, they receive a proposal regardless of performance or other factors). All the funds state that in selecting targets they also consider the stake they own, since this is directly linked to the payoff from value-improving actions, as well as to the clout with the company's management. They also consider how much of the target's stock is in institutional hands, because institutional investors are easier to coordinate with and are considered more likely to support a proposal.

Recent research is consistent with what the funds have told us about their selection criteria. For a sample of S&P 500 firms in the 1991–1992 proxy season, John and Klein (1995) find that the likelihood of a firm receiving a proposal sponsored by a pension fund is significantly negatively related to the previous two-year stock return, and positively related to firm size and institutional ownership. In addition, these two variables are not significant for any other type of proposal sponsor. Similarly, Karpoff et al. (1996) find that the probability of receiving a proposal is significantly positively related to firm size and institutional ownership, and negatively related to previous accounting performance and leverage. Carleton et al. (1998) find that the likelihood of being targeted by CREF is positively related to institutional ownership, negatively related to insider ownership, and unrelated to prior stock performance. Finally, Smith (1996) reports that target selection by CalPERS is positively related to firm size and institutional ownership, but unrelated to performance measures. However, the insignificance of performance is possibly due to the fact that by construction his comparison firms are also poor performers.

6.2. *Portfolio analysis: adjustments of holdings in target firm stocks*

Examining buying and selling behavior around proposals allows us to verify empirically what the funds tell us about their targeting and investment strategies, thereby providing a more complete picture of their behavior. Relating their targeting decisions to their trading patterns provides further evidence on fund motivation since we can assess the likely impact of their behavior on fund wealth.

All four primarily indexed funds claimed that over our sample period there is no relation between their activism programs and investment decisions. SWIB claims a minimal relation in that the investment staff is involved when choosing targets, but not after that point. Table 2 provides summary statistics on fund ownership stakes in target firms before and after the submission of a shareholder proposal. We do not analyze the ownership patterns for NYC since they do not report their portfolio holdings in a 13F filing directly to the SEC, which is the source of our portfolio data for the other funds.

Consistent with their indexing investment strategies, and with evidence in Wahal (1996), there is little evidence of trading around proposals by either

CalPERS, CalSTRS, or CREF. Even though we would expect CREF to exercise its ability to link trading decisions to their activism programs in the 16% of their internally managed portfolio that is not indexed, there is no evidence that they do. Their average ownership stake in target firms is 1%, the magnitude one would expect for an index fund, and the stake does not change much around targeting. In only six out of 32 targets does the stake appear to be significantly larger than 1%. The ownership stake in each firm under indexing can be estimated by dividing the dollars CREF devotes to indexing by the total market value of the index. (On 3/30/90 CREF indexed \$23.91 billion and the value of the S&P 500 index was \$2260.28 billion, which indicates that CREF's percentage ownership stake in each firm in the index should be 1.1%.) In contrast, SWIB's average ownership stake drops from 2.3% in the year before the first targeting to 0.4% in the year after the last targeting, while the median drops from 1.6% to zero.⁵ In the remainder of this section, we focus on the trading behavior of the actively managed SWIB, since they exercise the greatest flexibility in their portfolio decisions.

We expect a wealth-maximizing pension fund to submit a shareholder proposal only if they expect it to have a positive impact on firm value, and if this impact outweighs the cost. To profit from their anticipated positive impact on the stock price, an actively managed fund might increase their stake in the target firm prior to submitting a proposal (or at least not reduce their stake). After targeting, actions consistent with fund value maximization will depend on the success of the proposal. It could be that the fund will maintain the same stake either because they want to hold on long enough to reap the benefits of their targeting, or because they have positions too large to unload quickly. However, reducing their stake post-targeting is also consistent with fund value maximization since they could either be cutting their losses in an unresponsive target firm or realizing their positive gains from targeting. It makes less sense for the fund to increase their stakes post-targeting, but our strongest prediction is that we would expect a wealth-maximizing active fund to trade on their information. We test these predictions below.

⁵ Our conflicting results for SWIB are most likely due to Wahal's methodology of studying changes in activist funds' stakes in *all* target firms (i.e., those targeted by any fund), instead of in only those firms that they themselves target. We analyze a fund's ownership in only their own targets for two reasons. First, we are most interested in relating their alterations in portfolio investments to their decision to target firms with proposals. Assuming they react to the targeting decisions of other funds can mask this relation. Second, in interviews the funds were each very clear that they neither know nor care to know the details of what other funds are doing. For example, according to Richard Koppes at CalPERS, 'We don't really know how [other funds] put their program together, haven't spent the time to find out. We love and support our fellow public funds, but don't know what they're doing in advance'. Similarly, according to Kurt Schacht at SWIB, 'We don't own a lot of the companies that CalPERS owns'.

Panel A of Table 9 contains statistics on changes in the level of funds' ownership stakes in target firms beginning three years prior to the first targeting and ending one year after the last targeting. Ownership at time zero is defined as the holdings reported in the quarter ending after the outcome date, which is typically the annual meeting date. For example, if the outcome date is April 20, 1991, then time zero holdings are as of June 30, 1991. Thus, if the pension fund divests a stock immediately after the annual meeting, the time zero holding could be zero. They must hold the stock until then since shareholder proposal rules require the sponsor to present the proposal at the annual meeting.

For each fund and event period, we provide a benchmark value that we label the expected change in ownership stake. This benchmark is calculated using an estimate of each individual fund's portfolio turnover (excluding target holdings), and can be interpreted as the expected change in ownership stake if target holdings are turned over with the same frequency as in the rest of the portfolio. This measure is listed in the table as a positive value, even though either a positive *or* negative change of this magnitude in ownership stake would be considered normal for this pension fund. An advantage of this benchmark measure is that it accounts for differences across funds in portfolio turnover and in the size of the stake in target firms. Thus, if a fund has low turnover because they are heavily indexed, the expected change in target holdings would also be low. Appendix B describes this benchmark measure in more detail.

The observed patterns appear to be consistent with the funds' stated investment strategies and with fund value maximization. There are few changes in target holdings for the indexed funds, while SWIB appears to build positions in target firms prior to targeting and then divests them within one year of the last targeting. The change in ownership stake is 1.1% from three years to one year prior to the first targeting, and -1.8% from one year before to one year after the last targeting. Both of these changes are significantly different in absolute value from the expected changes using a standard *t*-test. In addition, all changes in SWIB's target ownership are significantly different from zero at the 5% level.

Panel B of Table 9 shows that SWIB completely divests 65% of its targets (11 out of 17) within one year of the last targeting, and 29% (5 out of 17) within one quarter. In contrast, none of the other funds divest target firms, consistent with their indexing strategy. These ownership patterns are especially interesting when combined with the results reported earlier. For example, we find that CalPERS' targets have significantly more announced corporate events in the years following the proposal than a matched control sample, while SWIB's targets do not. Since here we show that the majority of SWIB's targets are divested within the last year, it is possible that corporate managers are unresponsive to SWIB because they know that SWIB will go away, while CalPERS will not. However, we also find that SWIB's targetings are associated with significantly positive abnormal stock returns at the outcome date. Thus, their reduction in target

Table 9
Changes in target holdings for four pension funds

Panel A. This panel reports average annual changes in pension fund holdings based on quarterly 13F filings from June 1986 to June 1994. The targeting date is defined as the quarter of the proposal's outcome, which is typically the annual meeting date. Since many firms are targeted multiple times, the table below specifies whether the statistics are relative to the first or last targeting. For example, the first row of results reports changes in holdings from three years before to two years before the first targeting. The expected change benchmark is calculated using an estimate of each individual fund's portfolio turnover and can be interpreted as the expected change in ownership stake if target holdings are turned over with the same frequency as the rest of the portfolio. Appendix B describes this benchmark measure in more detail. Standard deviations are in parentheses

	SWIB		CALPERS		CALSTRS		CREF	
	Actual change	Expected change	Actual change	Expected change	Actual change	Expected change	Actual change	Expected change
(-3, -2)	0.011 ^a	0.002	0.0012	0.0009	0.0011 ^a	0.0006	-0.0006	0.0012
(<i>t</i> = 0 is first targeting)	(0.022)		(0.0027)		(0.0012)		(0.0027)	
(-2, -1)	0.009	0.003	0.0005	0.0013	0.0005	0.0007	-0.0004 ^a	0.0011
(<i>t</i> = 0 is first targeting)	(0.022)		(0.005)		(0.0019)		(0.0021)	
(-1, 0)	-0.010	0.0046	-0.0001	0.0011	0.0011	0.0006	0.0008	0.0012
(<i>t</i> = 0 is last targeting)	(0.021)		(0.0063)		(0.0035)		(0.0034)	
(0, 1)	-0.007	0.0024	-0.0021 ^a	0.0011	0.0001	0.0008	-0.0018	0.0012
(<i>t</i> = 0 is last targeting)	(0.014)		(0.0037)		(0.0041)		(0.0049)	
(-1, 1)	-0.018 ^a	0.007	-0.0022	0.0022	0.0012	0.0014	-0.0007 ^b	0.0024
(<i>t</i> = 0 is last targeting)	(0.026)		(0.0066)		(0.0075)		(0.0005)	

Panel B. This panel reports the percentage of a fund's targets that are completely divested within two years, one year, and one quarter after the outcome date of the final targeting.

	SWIB	CALPERS	CALSTRS	CREF
Percent of target holdings divested within				
Two years of last targeting	71	3	13	0
One year of last targeting	65	3	7	4
One quarter of last targeting	29	0	0	3

^aSignificantly different from the expected change at the 10% level.

^bSignificantly different from the expected change at the 5% level.

holdings after the outcome date is also consistent with them realizing some of the gains from their effort by selling stock, a possibility we explore below.

6.3. *Further analysis of SWIB'S ownership patterns*

In measuring SWIB's ownership patterns, we focus on the changes before the *first* targeting and after the *last* targeting. This could make it appear that SWIB gets in and out of stocks quickly, when actually there are several cases in which they target a firm several years in succession. To investigate potential motivations behind a decision to repeat targeting or to sell out of a position, we compare the average two-day outcome date CAR in the targets that are sold in the year after the outcome date versus those that are held. The average CAR in the held group is 1.1%, versus 0.4% in the sold group. This difference is statistically significant at the 10% level in a two-tailed test, and is confirmed by a regression with the change in percentage ownership from the year before to the year after the outcome date as the dependent variable and the outcome date CAR as the explanatory variable. This evidence is not consistent with SWIB exiting their position to immediately realize the outcome date abnormal return.

Another possible explanation for SWIB's exit pattern relates to the target selection strategy they describe to us in the interview. Specifically, they target the 'worst of the worst' performing firms in their portfolio, and only give up on them when it appears that the firm is not going to improve. To examine whether their behavior is consistent with this strategy, we compare the average excess returns in the year following the outcome date for two groups of stocks: SWIB's targets that are sold within a year of targeting and those that are held for that year. Using the CRSP value-weighted market index, the average market adjusted return is - 5.5% for those sold by SWIB and 0.9% for those held. Using the CRSP equally weighted market index, the market adjusted returns are - 2.8% and 4.3%. Because this test is based on a small sample, the sold and held groups are not statistically different from each other. However, 83% of the sold group (ten out of 12 targets) have returns below the CRSP value-weighted index and 67% (eight out of 12) have returns below the CRSP equally weighted index. This evidence is at least consistent with SWIB maximizing fund value with respect to the decision regarding whether to target the stock again or to sell out.

Overall, we find no evidence to support the hypothesis that public pension fund managers are politically motivated. In the previous section, we find no evidence that proposals sponsored by pension funds tend to decrease firm value or operating performance. In addition, our analysis of target selection and trading patterns around proposals shows that the funds' behavior appears to be generally consistent with their investment strategies and with fund value maximization. Even though the index funds in our sample cannot recoup their investment in activism through their trading, it is plausible that they benefit

from spillover effects from activism tools such as publicity that boost the performance of their portfolio as a whole. An exception, however, is CREF. Although its activism strategies and goals appear to be consistent with the internally and actively managed portion of the fund, we find that its trading strategies seem more consistent with its indexed portion.

7. Conclusions

We examine the impact and motivation of pension fund activism by studying the shareholder proposals submitted by five of the largest and most activist funds. To better understand the activism process, and consequently to form more precise tests, we interview key decision makers at these funds. We find that the sample funds differ in their activism objectives, their use of publicity as an activism tool, and their impact on target firms, and that these differences are generally consistent with the funds investment strategies.

We find that shareholder proposals are followed by significant additional corporate governance activity and broad corporate change, such as asset sales and restructurings. We also find evidence that proposals play a complementary role to other governance mechanisms. Specifically, firms targeted by CalPERS or subject to a proposal on antitakeover issues are significantly more likely to receive a hostile takeover bid, and targets of antitakeover proposals are more likely to experience a change in control than their matching comparison firms. We find no evidence that this activity has significant effects on stock return or accounting measures of performance in the three years following an initial targeting, and only sketchy evidence of positive effects in the short term. Finally, we find that portfolio movements of the pension funds are generally consistent with fund value maximization and with their stated investment strategies and activism objectives. We conclude that shareholder proposals are effective in promoting change at target companies, and that pension fund activism is not inconsistent with fund value maximization.

One caveat to our conclusions is that our sample period ends in 1993. Certain practices by the pension funds have changed since 1993 (e.g., CREF no longer publicly announces their targets, even after a successful negotiation), and thus the results of their activism today may differ from our findings. In addition, our sample is restricted to shareholder proposals, and thus represents only a portion of the governance activities of pension funds. For example, Smith (1996) and Wahal (1996) include fund letters to management in their samples, Opler and Sokobin (1997) study the Council of Institutional Investor's 'hit list', Carleton et al. (1998) study CREF's private negotiations with target firms, and Strickland et al. (1996) study USA's Target 50 list. Other activism activities not studied in this paper include lobbying the SEC for changes in the proxy rules and 'just vote no' campaigns.

Overall, our evidence indicates that shareholder proposals can be considered complementary elements in an array of governance mechanisms, each of which can be utilized as the situation demands. As there are a broad range of potential conflicts between shareholders and managers, it seems optimal to also have a broad range of mechanisms to resolve them. With only costly and highly contentious mechanisms such as tender offers and proxy contests, smaller conflicts would perhaps remain unresolved and worsen. Thus, when judging the effectiveness of shareholder proposals, it is important to recognize their potential value in a full spectrum of corporate governance tools.

Appendix A. Disaggregated results of Table 5

Table 10 contains the test results of comparing the post-targeting frequency of individual types of corporate events announced in the *Wall Street Journal* in target firms relative to a control sample matched by size, two-digit industry code, and accounting performance. We employ the nonparametric Mann–Whitney U test. Statistical significance indicates that the distribution of announced events in the target sample is significantly to the right of the control sample (*, **, and *** indicate statistical significance at the 10%, 5%, and 1% levels for a one-tailed test). In addition to the results of tests on the entire sample, we include the subsample results by proposal sponsor, proposal type, time period, and by whether the proposal passed, was withdrawn by the sponsor, or failed to get a majority of votes.

Appendix B. Calculation of the expected change in ownership stake benchmark

The fund- and period-specific benchmark value reported in Table 9 can be interpreted as the expected change in ownership stake if target holdings are turned over with the same frequency as the rest of the portfolio (non-target holdings). Specifically, we calculate the following for each fund and event window $t - 1$ to t :

$$\begin{aligned} & \text{Expected change in \% ownership stake}_{t-1,t} \\ & = \text{Average turnover ratio}_{\text{non-target}} \\ & \quad * \text{Average \% ownership stake in target firms}_{t-1}. \end{aligned}$$

This measure is listed in the table as a positive value, even though what we are really saying is that either a positive or negative change of this magnitude in ownership stake would be considered normal for this pension fund. For each fund we calculate the non-target stock turnover ratio for every year from 1986 to 1994. The average of these ratios is our estimate of the non-target turnover ratio.

Table 10

News categories	Full Sample	Fund sponsor			Proposal type			Date		Outcome					
		SWIB	CREF	CAL-PERS	CAL-STRS	NYC	Voting	Anti-take-over	Board issues	Multiple type	1987 to 1989	1990 to 1993	Passed	With-drawn	Failed
CEO retires	*														
CEO resigns unscheduled	*							*							**
Director resigns	***			***	**	*		**	*	***	*	*	*	*	**
Other top executive resigns	*			***	**	*		**	*			*	*	*	**
Shareholder lawsuit	*			***	**	*		*	*			*	*	**	
Non-sample proposal, etc.	*			**				*	*			*	*	*	
Proxy contest attempted															
Win seat(s) (proxy contest)															
Hostile takeover bid				*								*	*	*	
Hostile takeover defenses												*	*	*	
Hostile bid successful												*	*	*	
Merger/acquisition talks												*	*	*	
Merger/acquis. completed	*			***	*			**				*	*	*	
Asset sales or spinoff				***	*			**				*	*	*	
Major asset purchase												*	*	*	
Management buy-out												*	*	*	
Large insider purchase												*	*	*	
Large insider sale												*	*	*	
New/increase major block	*			*								*	*	*	
Major block sale												*	*	*	
Restructuring/reorganization	***			**	**	*		**	*			*	*	*	
Layoffs	***			**	**	*		**	*			*	*	*	
Increase dividends												*	*	*	
Decrease dividends	*			*				*	*		*	*	*	*	
Repurchase shares												*	*	*	
Issue shares												*	*	*	
Bankruptcy declared												*	*	*	
Accounting irregularities												*	*	*	
'No' vote for directors												*	*	*	

The following equations define our measure of annual non-target stock turnover, which is an estimate of the value-weighted turnover in non-target stocks.

- V_t^P = Value of the entire portfolio at time t
- V_t^{TAR} = Value of the target stocks held at time t
- V_t^{NON} = Value of the non-target stocks held at time $t = V_t^P - V_{t-1}^{TAR}$
- F_t^P = Flow in or out of the portfolio at time $t = V_t^P - V_{t-1}^P(1 + R_t^P)$
- F_t^{TAR} = Flow in or out of target stocks at time $t = V_t^{TAR} - V_{t-1}^{TAR}(1 + R_t^{TAR})$
- F_t^{NON} = Flow in or out of non-target stocks at time $t = F_t^P - F_t^{TAR}$

Turnover ratio_{non-target}

$$\begin{aligned} &= \frac{F_t^{NON}}{V_{t-1}^{NON}} \\ &= \frac{(V_t^P - V_{t-1}^P(1 + R_t^P)) - (V_t^{TAR} - V_{t-1}^{TAR}(1 + R_t^{TAR}))}{V_{t-1}^{NON}} \\ &= \frac{(V_t^P - V_t^{TAR}) - (V_{t-1}^P - V_{t-1}^{TAR}) - (V_{t-1}^P R_t^P - V_{t-1}^{TAR} R_t^{TAR})}{V_{t-1}^{NON}} \\ &= \frac{(V_t^{NON} - V_{t-1}^{NON}) - (V_{t-1}^P R_t^P - V_{t-1}^{TAR} R_t^{TAR})}{V_{t-1}^{NON}}. \end{aligned}$$

Because the returns on the portfolio components (R_t^P, R_t^{TAR}) are unavailable, we assume they are zero and use the following estimate:

$$\text{Turnover ratio}_{\text{non-target}} = \frac{(V_t^{NON} - V_{t-1}^{NON})}{V_{t-1}^{NON}}.$$

This turnover estimate will be biased upwards as long as $V_{t-1}^P R_t^P - V_{t-1}^{TAR} R_t^{TAR} > 0$, which will be true as long as returns are positive. Thus, the test is conservative as long as returns are generally positive since it will be harder to reject the null hypothesis of target holdings turnover being the same as ‘normal’ turnover. The estimates of average annual non-target turnover ratios are 0.2062 for SWIB, 0.1103 for CREF, 0.1244 for CalPERS, and 0.1499 for CalSTRS.

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